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# Collecting Data: How will the ESRB Overcome the First Hurdle towards Effective Macro-prudential Supervision?

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## Abstract

This article provides a critical assessment of the European Systemic Risk Board's ('ESRB') data collection process and examines the likely effectiveness of the legal frameworks, mechanisms and structures set out to accommodate it. It presents the various sources from which the ESRB collects its data in order to produce, where necessary, concrete warnings and remedial recommendations regarding risks to the financial stability within the EU. The article then points to possible impediments to the smooth flow of information through these channels of information and suggests ways to refine the data collection process. It further explores two pressing areas where information gaps are most apparent: shadow banking and systematically important institutions. It concludes that there are indeed various challenges and possible obstacles to smooth flow of information both in the legal frameworks and the practical mechanisms of the data collection process. Yet, the ESRB's information base and its data collection mandate are wide enough to tailor its macro-prudential analysis needs and are far from being a duplicating effort of other national and international players.

## 1. Introduction

In the midst of the sovereign debt crisis, bailing out plans and gloomy predictions as to the future of the euro zone, it is hardly surprising that the European Systemic Risk Board (the 'ESRB') has been kept out of public eye and academic discussion. The ESRB was established in January 2011 and forms part of the European System of Financial Supervision (the ESFS).<sup>1</sup> The ESFS is aimed at ensuring the supervision of the financial system in the EU and bringing together the actors of the

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\* A PhD Candidate and a Teaching Fellow, University College of London. I would like to thank Iris Chiu, Arad Reisberg, Philip Rawlings and Miriam Goldby for their useful comments. The usual disclaimer applies.

<sup>1</sup> Council Regulation (EU) 1092/2010 of 24 November 2010 on European Union Macro-prudential Oversight of the Financial System and Establishing a European Systemic Risk Board [2010] OJ L331/1 (the "ESRB Regulation"); Council Regulation (EU) 1096/2010 of 17 November 2010 on Conferring Specific Tasks upon the European Central Bank Concerning the Functioning of the European Systemic Risk Board [2010] OJ L 331/162 (the "ECB Regulation").

financial supervision both at the national and at the EU level to act as a network.<sup>2</sup> At the EU level, this network comprises the ESRB and three newly established authorities: the European Banking Authority, the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority (collectively referred to as the ‘European Supervisory Authorities, hereinafter the ‘ESAs’) and the Joint Committee of the ESAs.<sup>3</sup> At the national level, the ESFS comprises the competent or supervisory authorities in the Member States as specified in the legislation establishing the ESAs.<sup>4</sup> The ESRB is entrusted with the macro-prudential oversight of the financial system within the EU, contributing to the prevention or mitigation of systemic risks to financial stability.<sup>5</sup> Systemic risk is defined as a risk of disruption in the financial system with the potential to have serious negative consequences for the internal market and the real economy.<sup>6</sup>

The borders of macro-prudential framework, as a separate policy from more “traditional” ones, such as monetary and fiscal policies and its policy tools sparked vast academic and policy debate in recent years.<sup>7</sup> Complemented by technical work of developing tools to measure and analyse systemic risks, it seems that the research of macro-prudential supervision is put on the fast track.<sup>8</sup> This Article is concerned with a much narrower area though its importance merits wider discussion: the collection of relevant data by the ESRB for macro-prudential supervision of the financial system

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<sup>2</sup> The ESRB Regulation, Preamble para. 14.

<sup>3</sup> Council Regulation (EU) 1093/2010 of 14 November 2010 Establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission decision 2009/78/EC [2010] OJ L 331/12 (the “EBA Regulation”); Council Regulation (EU) 1094/2010 of 24 November 2010 Establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority), amending Decision No 716/2009/EC and repealing Commission decision 2009/79/EC [2010] OJ L 331/48 (the “EIOPA Regulation”); Council Regulation (EU) 1095/2010 of 24 November 2010 Establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC [2010] OJ L331/84 (the “ESMA Regulation”); The EBA Regulation, the EIOPA Regulation and the ESMA Regulation are together referred to as the “ESAs Regulations”, Arts 2 and 54–57, respectively.

<sup>4</sup> The ESRB Regulation Arts 2–3; The EBA Regulation, the EIOPA Regulation and the ESMA Regulation, Arts 2(2)(f), respectively.

<sup>5</sup> The ESRB Regulation, Art. 3(1).

<sup>6</sup> The ESRB Regulation, Art. 2(c). On the nature of systemic risks see e.g., ECB, ‘The Financial Stability Review’ (June 2010), 141 <<http://www.ecb.int/pub/pdf/other/financialstabilityreview201006en.pdf>> accessed 10 November 2011

<sup>7</sup> As well as on the interaction between macro-prudential policy and other more “traditional” policies, such as monetary and fiscal policies. For a comprehensive overview of the academic and policy literature on the macro aspect of financial regulation see, for instance, Gabriele Galati and Richhild Moessner, *Macro-prudential Policy – A Literature Review* (2011) BIS Working Papers No 337) <<http://www.bis.org/publ/work337.pdf>> accessed 16 April 2012.

<sup>8</sup> Forecasting Financial Crises (FFC) is a three-year scientific project funded by the European Commission working on understanding and possibly forecasting systemic risk and global financial instabilities, see <http://www.focproject.net>. Another European project is the research network of Macro-prudential Regulation and Supervision (MaRs) which is aimed at developing analytical instruments for macro-prudential oversight.

within the EU. Collection of all the relevant and necessary data is a precondition to effective macro-prudential oversight and therefore requires a careful consideration. The Article examines the strengths and weaknesses of the exchange of information process in this context and assesses the likely effectiveness of the legal frameworks, mechanisms and structures set out to accommodate it. The conclusions drawn in this Article could guide policy-making intended to establish a reliable macro-prudential supervisory system in the EU.

## 2. Legal Framework of Data Collection – A Critical Assessment

Establishing a legal framework in this area and efficient mechanisms by which this legal framework is converted into action is a complex and multi-faceted undertaking. Four main reasons can be offered to explain this complexity.

First, following the 2007–2008 financial crisis there is a wide consensus on the need for macro-prudential supervision. Yet, there is no commonly-agreed definition of macro-prudential supervision, its effects are largely untested and the borders with micro-prudential supervision are not fully defined. In addition, the development of macro-prudential analysis is still in its infancy and, therefore, there is no single approach to measure and assess systemic risks, which is necessarily exclusive or exhaustive. This means that data requirements of the ESRB will vary depending on the type of approach it utilises to identify and analyse the collected data. Initially, it is unlikely that a single approach will be taken to measure and analyse the collected data and accordingly data requirements will remain, in the short term, fluid and somewhat generic.<sup>9</sup> The lack of a clear working frame for the ESRB suggests that there could be dangerous uncertainty in the exchange of information process, at least in its initial stages.<sup>10</sup>

Secondly, issues concerning data collection process by the ESRB arise within a broad contextual background. The ESRB's mandate covers wide range of areas, from the financial situation of banks, insurance companies and Alternative Investment Funds to the potential existence of asset bubbles or the good functioning of the market infrastructures. The cross-sectoral nature of systemic risks necessitates a wide

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<sup>9</sup> The decision which data is needed will be made according to the chosen approach/es to measuring systemic risks. For instance, if a network approach is taken then the focus will be on mapping the interlinkages between financial institutions which require, among others, data about interbank loans, including cross-border exposures as well as information on credit risk transfer. See Deloitte & Touche and Securities Industry and Financial Market Association, *Systemic Risk Information Study* (June 2010) <[http://www.sifma.org/uploadedfiles/newsroom/2010/sifma\\_systemic\\_risk\\_information\\_study\\_june\\_2010.pdf](http://www.sifma.org/uploadedfiles/newsroom/2010/sifma_systemic_risk_information_study_june_2010.pdf)> accessed 10 November 2011; Peter Praet, *Macro-prudential and Financial Stability Statistics to Improve Financial Analysis of Exposures and Risk Transfers* (Fifth ECB Conference on Statistics, Frankfurt, 22–23 April 2010) <[http://www.ecb.int/events/pdf/conferences/stats\\_conf/101019\\_session1\\_praet.pdf?cb47c7de3b5bc869191a3bb5c9e411b9](http://www.ecb.int/events/pdf/conferences/stats_conf/101019_session1_praet.pdf?cb47c7de3b5bc869191a3bb5c9e411b9)> accessed 10 November 2011.

<sup>10</sup> The first 5 years of its operation, in line with the time of the review of the ESRB mission and organisation according to Art. 20 of the ESRB Regulation.

mandate for the ESRB. However, this overreaching surveillance radar creates further challenges. The legal frameworks that allow the sharing of information with the ESRB and the reporting requirements differ from one sector to another and, therefore, at least until harmonisation is reached, the data collected and the manner it is collected across various sectors will differ as well. These result, for instance, in lack of data comparability and, naturally, will be an impediment for an efficient macro-prudential analysis.

Thirdly, the process of data collection in this area is, by its very nature, an evolving process and the ESRB data needs will be constantly reevaluated and adjusted. The fast moving and opaque nature of financial markets and the search for less or non-regulated areas which may pose systemic risks to the financial stability dictate the dynamic nature of data collection. Accordingly, there is a tension within the legal framework between the need, on the one hand, to cast the net wide to allow for these adjustments and the need to be specific to tailor the technical requirements in this area.

Finally, the ESRB is part of a complex and delicate institutional environment. Complex – since it involves newly established institutions at the EU level as well as long-standing actors of financial supervision at the national and international level and other exiting frameworks for information exchange.<sup>11</sup> Diagram A below sets out the institutional environment in this area and conveys its complexity; Delicate – since the data collection process involves issues of confidentiality and general willingness (or unwillingness) of supervisors within and outside the EU to cooperate with the ESRB and disclose information. A successful data collection entails therefore the establishment of open channels between the ESRB and these institutions whereby information can be exchanged smoothly without any legal or practical obstacles. Much will depend on the cooperation of these institutions with the ESRB, their willingness to establish defined legal frameworks and to follow them on in practice.

This Article focuses on these channels of information and the functioning of the ESRB as a central hub, pooling data from various sources and connecting them to create a constantly changing systemic risk map within the EU. It examines the legal frameworks and the practical mechanisms within which these channels operate. Following this introduction, section 2 outlines the legal framework empowering the ESRB to collect the information needed to prevent or mitigate systemic risks to financial stability. It provides a critical assessment of this legal framework; identifies possible obstacles to the smooth flow of information and suggests ways to refine the data collection process. Section 3 sketches out the essential features of the information that the ESRB should collect in order to fulfil its mission successfully. Section 4 presents the various sources from which the ESRB collects its data and points to possible impediments to the smooth flow of information with each one of them. It suggests that the ESRB uses a wide information base which equips it to create a unified and clear jigsaw puzzle of the financial system in the EU and its emerging risks. Section 5 focuses on two pressing areas where information gaps are most apparent: the

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<sup>11</sup> Such as colleges of supervisors, see section 4 below on pp 33–34.

shadow banking and systematically important institutions. Section 6 identifies the main difficulties in the systemic risk analysis stage that have a direct impact on the data collection process. Finally, section 7 draws the conclusion that the ESRB is far from being a duplicating effort of existing players in the regional and international level. Indeed, the ESRB relies on available information already being collected by central banks and other international institutions. However, it offers data collection process which is tailored to the European environment and complies with macro-prudential analysis needs and to some extent, with the quality requirements of such data.



Diagram A

*The ESRB’s Task to Collect All Relevant and Necessary Data*

The importance of availability of all the relevant information required to identify macro-prudential risks is emphasised in the de Larosière Report and numerous other reports that followed the financial crisis.<sup>12</sup> Reflecting this, one of the tasks of the ESRB under Art. 3(2) of the ESRB Regulation is:

*to determine and/or collect and analyse all relevant and necessary information for the macro-prudential oversight of the financial system within the Union in order to contribute to the prevention or mitigation of systemic risks to financial stability in the Union arising from developments within the financial system, tak-*

<sup>12</sup> The European Commission, *The Report of the High-level Group on Financial Supervision in the EU* (February 2009) (hereinafter “the de Larosière Report”); FSB and IMF, *The Financial Crisis and Information Gaps* (Washington D.C., October 2009) <<http://www.imf.org/external/np/g20/pdf/102909.pdf>> accessed 10 November 2011; FSB and IMF, *The Financial Crisis and Information Gaps, Implementation Progress Report* (June 2011) <<http://www.imf.org/external/np/g20/pdf/063011.pdf>> accessed 10 November 2011.

*ing into account macroeconomic developments, so as to avoid periods of widespread financial distress. It shall contribute to the smooth functioning of the internal market and thereby ensure a sustainable contribution of the financial sector to economic growth.*

Article 15 entrusts the ESRB with the powers to perform this task. Art. 15(2) provides that the European Supervisory Authorities (the ESAs), the European System of Central Banks (ESCB), the Commission, the national supervisory authorities and national statistics authorities shall cooperate closely with the ESRB and shall provide it with all the information necessary for the fulfilment of its tasks in accordance with EU legislation.

According to Art. 15(3) the ESRB may request information from the ESAs, as a rule, in summary or aggregate form such that individual financial institutions cannot be identified.<sup>13</sup> However, before requesting this information, the ESRB has first to take account of the existing statistics produced, disseminated and developed by the European Statistical System (ESS) and the ESCB.<sup>14</sup> The order of these subsections is somewhat cumbersome as the order by which the ESRB will receive the necessary information is first conducted under Art. 15(4) of the ESRB Regulation and only then under Art. 15(3).

If the requested information is not available or is not available in a timely manner the ESRB may request it from the ESCB, the national supervisory authorities or the national statistics authorities and if the information remains unavailable the ESRB may request the information from the Member State concerned.<sup>15</sup>

Articles 15(6) and 15(7) deal with a reasoned request for information, which is not in summary or aggregate form. Under these sections the ESRB is required to submit, after consulting with the relevant ESA, a justified and proportionate request, explaining why the data is deemed to be systemically relevant and necessary, considering

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<sup>13</sup> Subject to Art. 36(2) of the EBA Regulation, the EIOPA Regulation and the ESMA Regulation, respectively.

<sup>14</sup> The ESRB Regulation, Art. 15(4).

The European Statistical System (hereinafter the ESS) is the partnership between the Community Statistical Authority (referred to as 'the Commission (Eurostat)'), the national statistical institutes and other national authorities responsible in each Member State for the development, production and dissemination of European statistics. See Council Regulation (EC) 223/2009 on European Statistics and repealing Regulation (EC, Euratom) No 1101/2008 on the Transmission of Data subject to Statistical Confidentiality to the Statistical Office of the European Communities, Council Regulation (EC) No 322/97 on Community Statistics, and Council Decision 89/382/EEC, Euratom establishing a Committee on the Statistical Programmes of the European Communities [2009] OJ L 87, which consolidated the activities of the ESS and improved its governance. It is to be noted that European statistics is developed, produced and disseminated by both the ESS and the ESCB under separate legal frameworks. For the latter, see Council Regulation (EC) 2533/98 of 23 November 1998 concerning the Collection of Statistical Information by the European Central Bank [1998] OJ L 318, p 8, as amended.

<sup>15</sup> The ESRB Regulation, Art. 15(5). The reference here is to 'the requested information', it is to be assumed that this means the requested information from the ESAs, following consideration of existing statistics, under Arts 15(3) and 15(4) of the ESRB Regulation.



the prevailing market situation. The Article does not state clearly whether the ESRB will submit the request to the addressee directly (individual financial institutions) or via the ESA or the national supervisors. The procedure here is important and extends beyond technicality. On the one hand, in cases where national supervisors do not have the required information on individual financial institutions it will be more efficient for the ESRB to be able to obtain the information directly from the institutions. On the other hand, the ESRB does not have a legal personality<sup>16</sup> and this could stand as an obstacle for requesting the information directly from the individual financial institutions. On balance and considering the sensitivity of abstaining non-aggregate information on individual financial institutions, it is suggested that collection should be made via the ESAs. This will be in line with the collection of aggregate information on an ad hoc basis which targets minimum interaction with reporting agents.<sup>17</sup>

If the relevant ESA does not consider the request to be justified and proportionate, it will send the request back to the ESRB and ask for additional justification. Article 15(6), however, does not clarify what will be the procedure in case the additional justification provided by the ESRB does not convince the relevant ESA that the request is justified and proportionate.<sup>18</sup>

There are further essential issues concerning collection and exchange of information that were overlooked in Art. 15. Even though the ESRB Regulation acknowledges the importance of cooperation with international institutions, such as the International Monetary Fund (IMF) and the Financial Stability Board (FSB), as well as other relevant bodies in third countries,<sup>19</sup> Art. 15 does not include any provision regarding exchange of information with these institutions. Furthermore, neither Art. 15 of the ESRB Regulation nor Art. 35 of the EBA Regulation, the EIOPA Regulation and the ESMA Regulation, respectively, specifies any method whereby the rights of access to information may be enforced or any procedure whereby disagreements are to be resolved.<sup>20</sup>

<sup>16</sup> The ESRB was established on the basis of Art. 114 of the Treaty on the Functioning of the European Union (TFEU) [2010] OJ C 83/47. See also the ESRB Regulation, Preamble, para. 15. This is to be contrasted with the ESAs that have separate personality, see, for instance, the EBA Regulation, Art. 5.

<sup>17</sup> See n 30 below the Decision of the ESRB of 21 September 2011 on the Provision and Collection of Information for the Macro-prudential Oversight of the Financial System within the Union, Part B Art. 3. The Decision does not define 'reporting agents' however referring to the Council Regulation (EC) No 2533/98 concerning the Collection of Statistical Information by the European Central Bank (1998) OJ L 318 this will include individual financial institutions under discussion here.

This is to be contrasted with the position in the U.S. The Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law No 111 – 203 enacted on July 21, 2010) established the Office of Financial Research (OFR) (section 512) to support the Financial Stability Oversight Council (The ESRB equivalent in the U.S.) *inter alia* by requesting data directly from firms by subpoena (section 153(f)).

<sup>18</sup> This aspect of requesting information in a non-aggregate form will be further explored in section 3 of this Article.

<sup>19</sup> The ESRB Regulation, Preamble para. 7 and Art. 3(2)(i).

<sup>20</sup> Interestingly, a provision referring to the enforcement of the ESRB rights to collect information was suggested in the European Parliament's Report on the Proposal for a Regulation of the European Parliament and of the Council on Community Macro-prudential Oversight of the Financial System and Establishing a European Systemic Risk Board 2009/0140 (COD), amendment 79 proposing a new



### *Confidentiality*

The constraints to the right to access information can be found in Art. 8 of the ESRB Regulation, which sets out confidentiality obligations. Article 8(1) provides the general prohibition and requires the Members of the General Board and any other persons who work or who have worked for or in connection with the ESRB not to disclose information that is subject to professional secrecy, even after their duties have ceased. The information received by members of the ESRB can be used only in the course of their duties and in performing the tasks as set out in Art. 3(2) of the ESRB Regulation.<sup>21</sup> This provision is essential given the European Central Bank's (ECB) role in ensuring the ESRB Secretariat and the reliance on its resources, on the one hand and the need to ensure that the independence of the ESRB and the ECB is preserved, on the other hand.<sup>22</sup> In practical terms, it implies the establishment of a chinese wall between the ESRB and the ECB and, to this end, internal rules were established, as prescribed in Art. 6(3) of the ECB Regulation.<sup>23</sup> These rules will ensure that the support provided by the ECB to the ESRB is conducted without prejudice to the principle of independence of the ECB in the performance of its tasks pursuant to the Treaty on the Functioning of the European Union (hereinafter: the 'Treaty').<sup>24</sup>

Finally, to prevent identification of individual financial institutions, confidential information obtained while performing the ESRB tasks cannot be divulged to any person or authority whatsoever, except in summary or aggregate form.<sup>25</sup> This sweeping restriction may clash with Arts 15(6)–(7), which allow, under certain conditions, disclosure of information that is not in summary or aggregate form. It may restrict the ability of the ESRB to address appropriate warnings and recommendations to the

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paragraph 4a as follows: "If information referred to in this Article is not made available or in the event of an emergency, the General Board may call on the European Parliament and the Council to act in an appropriate way." This proposed amendment was not included in the final version of Art. 15 of the ESRB Regulation.

<sup>21</sup> ESRB Regulation, Art. 8(2) and ECB Regulation, Art. 6(4).

<sup>22</sup> On the interaction and possible conflict between the monetary policy and macro-prudential policy see for instance, Alastair Clark and Andrew Large, *Macroprudential Policy: Addressing the Things We Don't Know* (Occasional Paper 83, Group of Thirty, Washington, DC, 2011)

<sup>23</sup> According to Art. 22 of the Decision of the ESRB of 20 January 2011 adopting the Rules of Procedure of the European Systemic Risk Board (ESRB/2011/1) OJ C 58/4, the ESRB Secretariat will classify and handle information and documents in accordance with the ECB internal rules and any supplementary rules adopted by the ESRB/ECB for that matter. See the ECB Decision of 19 February 2004 adopting the Rules of Procedure of the European Central Bank, ECB/2004/2, OJ L 080/33.

<sup>24</sup> [2010] OJ C 83/47, Art. 282(3). See the ESRB Regulation, para. 6 of the preamble; the ECB Opinion of 26 October 2009 on a Proposal for the ESRB Regulation and the ECB Regulation (2009/C 270/01) emphasising in para. 4 that the involvement of the ECB and ESCB in the ESRB will not alter the primary objective of the ESCB under Art. 105(1) of the Treaty, which is to maintain price stability and that its supporting activities for the ESRB will not affect the ECB's institutional, functional and financial independence.

<sup>25</sup> The ESRB Regulation, Art. 8(3).

relevant Member State, ESA or the national supervisory authority, where it identifies an individual institution as posing systemic risk for the financial system.

In order to safeguard information regarding individual financial institutions and information from which individual financial institutions can be identified the ESRB, together with the ESAs, will agree on specific confidentiality procedures.<sup>26</sup> Such an agreement between the ESRB and the ESAs was signed in November 2011 and is to be reviewed within a year by the parties.<sup>27</sup> The agreement provides detailed procedures on staff access to confidential information regarding individual financial institutions and the secured storage of that information. In particular, the agreement provides that the exchange of information between the parties will be done through a separate area in the ESRB's electronic collaboration tool (DARWIN). The data stored on the DARWIN file is encrypted, with highly restricted access and even contains an audit trail of all access.<sup>28</sup>

Unfortunately, Art. 8 does not provide any indication of what are the consequences where there is a failure to comply with its prohibitions. In particular, unlike Art. 70(4) of the EBA Regulation, the EIOPA Regulation and the ESMA Regulation, respectively, it does not refer to Commission Decision 2001/844/EC, ECSC, Euratom [2001] OJ L317/1 of 29 November 2001, which provides for security of EU classified information. According to paragraph 24.3 of the Annex on the Rules on Security to this decision, any individual who is responsible for compromising EU classified information will be subject to a disciplinary action, such as a written warning, downgrading or suspension.<sup>29</sup> In order to ensure a strict safeguard of confidential information Art. 8 should incorporate sanctions for breach of its provisions and refer to this decision in line with the ESAs Regulations.

### *The Mechanism and Guiding Principles of the ESRB's Data Collection Exercises*

The mechanism and guiding principles of the ESRB's data collection exercises are set out in the Decision of the ESRB of 21 September 2011 on the Provision and Collection of Information for the Macro-prudential Oversight of the Financial System within the Union (hereinafter: 'the Decision').<sup>30</sup> The Decision outlines the

<sup>26</sup> The ESRB Regulation, Art. 8(4).

<sup>27</sup> Agreement between the EBA, the EIOPA, the ESMA and the ESRB on the Establishment at the ESRB Secretariat of Specific Confidentiality Procedures in order to Safeguard Information regarding Individual Financial Institutions and Information from which Individual Financial Institutions can be Identified, 25 November 2011. The agreement is available at <[http://www.esrb.europa.eu/pub/pdf/111125\\_agreement\\_EBA\\_EIOPA\\_ESMA\\_ESRB.pdf?187795e45ccb8f122ed7fbcac125827e](http://www.esrb.europa.eu/pub/pdf/111125_agreement_EBA_EIOPA_ESMA_ESRB.pdf?187795e45ccb8f122ed7fbcac125827e)> accessed 10 November 2011.

<sup>28</sup> *Ibid.*, Art. 5.

<sup>29</sup> According to the relevant rules and regulations, particularly title VI of the Staff Regulations of Officials of the European Union and the Conditions of Employment of Other Servants of the European Union, as laid down in Regulation 259/68 (EEC, Euratom, ECSC) [1968] OJ L 56. The specific rules on disciplinary actions are set out in Annex IX of the Staff Regulations.

<sup>30</sup> ESRB/2011/6, OJ C 302/3.

aggregated information required by the ESRB for the performance of its tasks and lays out detailed rules for the provision and collection of that information.<sup>31</sup>

The Decision is divided into two main sections: (i) regular provision of the aggregated information required by the ESRB for the performance of its tasks and (ii) ad hoc provision of aggregated information. Thus, both ongoing data collection and ad hoc troubleshooting are provided as tools for the ESRB macro-prudential analysis. The provisions governing regular provision of the aggregated information by the ECB and by the respective ESAs are specified in Annexes I and II, respectively.<sup>32</sup> The procedures that the ESRB Secretariat will apply to carry out requests for aggregated information on an ad hoc basis are prescribed in Annex III.<sup>33</sup>

Annex I lists published and non-published datasets that the ECB reports for the eurozone in the area of monetary and financial statistics.<sup>34</sup> The datasets include, for instance, the Consolidated Banking Data, which covers data on balance sheet, profit and loss account and solvency of banking groups on an aggregated basis.<sup>35</sup> With regard to non-eurozone Member States, the Decision mentions briefly that the ECB collects information solely on a voluntary basis with the approval of the relevant national central banks. This gap is unsatisfactory and is further exacerbated by the criticism that the ESRB governance does not represent non-eurozone countries sufficiently.<sup>36</sup> To ensure that all relevant information on non-eurozone countries is available to the ESRB the information gap should ideally be remedied but in practical terms this may not be feasible. Legal acts and instruments of the ECB, defining the actual reporting population and its reporting requirements, are directly applicable and binding in the euro area alone.<sup>37</sup> Their implementation in the non-euro area is achieved on a voluntary basis mostly in the context of preparation for entry into the euro area.<sup>38</sup> This incentive does not exist for Member States, such as the UK, that do not wish to join the eurozone. The ECB should, therefore, aim at promoting voluntary implementation of its reporting requirements and a statement in this spirit should be included in the Decision. This suggestion is in line with Art. 5 of the ESCB Statute<sup>39</sup>

<sup>31</sup> The Decision, Art. 1.

<sup>32</sup> The Decision, Arts 2(2)-2(3).

<sup>33</sup> The Decision, Art. 3.

<sup>34</sup> The content, frequency and timeliness of these datasets are regulated either by the legal acts referred to in annex I or as established in common practice.

<sup>35</sup> The Decision, Annex I s 6. The Council Regulation (EC) No 951/2009 of 9 October 2009 amending Regulation (EC) No 2533/98 concerning the collection of statistical information by the European Central Bank OJ L 269/1, preamble, paras 3–4 reflects the ESCB macro-prudential statistics needs and enables the ECB to require information for financial stability purposes from the entire sector of financial corporations (in particular from insurance companies and pension funds).

<sup>36</sup> See, for instance, Williem Buiter, *The Proposed European Systemic Risk Board is Overweight with Central Bankers* (Williem Buiter's Mavericon, FT.com, 28 October 2009) <<http://blogs.ft.com/mavercom>> accessed 10 November 2011.

<sup>37</sup> In the form of regulations or guidelines.

<sup>38</sup> Council Regulation (EC) No 2533/98 of 23 November 1998 concerning the Collection of Statistical Information by the European Central Bank, Preamble paras 14 and 17.

<sup>39</sup> Protocol on the Statute of the European System of Central Banks and the European Central Bank annexed to the Treaty establishing the European Community (OJ C 191, 29.7.1992, p 68), as amended.

that entrusts the ECB with the task of collecting statistical information and applies to all Member States, irrespective of their adoption of the euro and with Art. 15(4) of the ESRB Regulation that refers explicitly to the ESCB as the source of information.

Annex II lists the aggregated information provided by the ESAs and ensures the protection of firm-level data and identification of specific institutions from the disclosed information. The general rule here is that the aggregated information will comprise data on at least three legal persons, none of which represents 85% or more of the relevant market, whether it consists of one or more Member States or the Union as a whole. However, if dispersion measures are disclosed to the ESRB in addition to the aggregated information, the information is more granular.<sup>40</sup> In that case, the aggregated information will comprise data on at least five legal persons when referring to publicly available data and on at least six legal persons when there is a need to protect confidential firm-level data. These specific granularity restrictions are contrasted with the flexible granularity restrictions of information collected via ad hoc surveys under Annex III. Annex III does not prescribe a rule of thumb for the granularity of the information collected for the purpose of these surveys but rather relies on the decision of the ESRB General Board that may determine the granularity on an institutional and item level. This mechanism is welcomed and will allow the ESRB to access more granular information in times of financial crisis on an ad hoc basis. It should be considered though whether the Decision should have put in place a mechanism to allow adjustments in the granularity of information in times of crisis under the regular pooling of information in Annex II as well. For instance, the Decision can provide that the ESRB General Board may decide that more granular information is needed in the regular provision of aggregated information by the ESAs, considering the prevailing market situation.

Specific sections on provision of information by each one of the ESAs follow the granularity restrictions in Annex II. The EBA is required to report datasets for a sample of large banking groups as defined together with the ESRB.<sup>41</sup> The information will be transmitted to the ESRB quarterly, 5 working days following the EBA's receipt of data from the National Supervisory Authorities (the NSAs).<sup>42</sup> This is quite an impressive time span, in particular when contrasting it with the one year time span of information provided by the EIOPA.<sup>43</sup> It can be further observed that the Decision assumes that specific but material agreements regarding regular provision of information between the ESRB and the EBA are to be followed. Accordingly, the date of the first transmission of information is left to be agreed between the ESRB and the EBA with no specific time frame prescribed for such an agreement to be reached. The definition of a large banking group is again subject to an agreement between the ESRB and the EBA and the Decision does not provide the considerations that should be

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<sup>40</sup> Dispersion measures are not defined in the Decision. Measures of dispersion are the quantities that characterise the 'spread' of the data (Unesco.org).

<sup>41</sup> These datasets include data from COREP and FINREP templates, data on liquidity and data from the EBA common reporting of large exposures templates (Annex II, paras A1-A3).

<sup>42</sup> Which occurs 90 days after the reference date.

<sup>43</sup> It remains to be seen if this will be adhered to in practice.

taken into account<sup>44</sup> or how often the list of these groups will need to be revaluated. The flexible nature of the Decision is understandable considering the fast changing data needs of the ESRB however this is subject to reaching concrete agreements with time frames and revaluation targets.

Lastly, the Decision provides that no historical information is required from the EBA. This is surprising, particularly when contrasting it with the information to be provided by the EIOPA, which goes back to 2003 and from the ESMA, which goes back to 2007. Collecting historical information is essential for macro-prudential analysis due to the time dimension of systemic risks, ie the need to evaluate how these risks in the financial system evolve over time.<sup>45</sup> Therefore, it is to be regretted that the ESRB failed to incorporate this requirement in the banking area as well.

The subsequent section in Annex II lays out the datasets that the EIOPA will report to the ESRB. In contrast with the requirements applicable to the EBA, the information here will be disclosed on an annual basis however it will include datasets which refer not only to large Union insurance companies as identified by EIOPA but to all Union insurance companies. The last section lists the datasets that will be provided by the ESMA, collected in cooperation with the NSAs and transmitted on a quarterly basis.

Annex III specifies the conditions under which the ESRB may request aggregated information to be provided on an ad hoc basis. The procedure aims at avoiding duplication of efforts and therefore initial ad hoc requests for aggregated information submitted by the ESRB will generally first trigger an investigation phase.<sup>46</sup> This phase, organised by the Secretariat with the support of the ECB, will identify whether an ad hoc survey needs to be carried out.<sup>47</sup> In particular, it will assess what quantitative and qualitative data are already available (from the ESCB, the ESAs, commercial data providers or international organisations) and whether they are fit for purpose. The Decision does not define the term ‘fit for purpose’ or refer to other document for guidance. It is submitted in section 3 below that the term should be interpreted widely to include not only data that meets the ESRB objectives as set out in Art. 2 of the ESRB Regulation. It should encompass data that meets the expectations of the key

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<sup>44</sup> Balancing the need to minimise reporting burden and avoid the exclusion of relevant groups from the reporting obligations.

<sup>45</sup> The source of system-wide financial distress in the time dimension is the procyclicality of the financial system. The time dimension complements the cross-sectional dimension (dealing with how risk is allocated with the financial system at a point in time). In the cross-sectional dimension, the sources of risk are the common exposures and interlinkages in the financial system. See Jaime Caruana, *Systemic Risk: How to Deal with It?* (BIS, 12 February 2010) <<http://www.bis.org/publ/othp08.htm>> accessed 10 November 2011; Claudio Borio, *Rediscovering Macroeconomic Roots of Financial Stability Policy: Journey, Challenges and a Way Forward* (2011) BIS Working Papers No 354 <<http://www.bis.org/publ/work354.pdf>> accessed 10 November 2011.

<sup>46</sup> The Decision, Annex III, para. 1.2.

<sup>47</sup> The Decision, Annex III, para. 4.1. In case the ESRB and one or more ESAs agree, due to their common interest in a specific topic, to launch a joint ad hoc survey, an investigation phase will be unnecessary, The Decision, Annex III, para. 1.3.

stakeholders, such as the various data sources through which data is transferred to the ESRB and the reporting agents from which data is being collected, as well.

Where the data is not available or not fit for purpose and there is need for the data to be collected from reporting agents through an ad hoc survey, the investigation phase may identify the relevant reporting population and broad cost implications for the reporting agents in carrying out such a survey. The outcome of the investigation phase may entail the adoption of a decision by the ESRB's General Board for aggregated information to be collected via an ad hoc survey.<sup>48</sup> In deciding whether an ad hoc survey is needed, the ESRB's General Board will be informed of and will take into account the likely costs involved and the timetable for conducting such a survey.<sup>49</sup> Its decision may determine the granularity of the required information on an institutional and item level, the confidentiality regime to be applied, in particular who will be allowed to access which data and how data will be stored and transmitted and the time limits for provision of the information.<sup>50</sup>

Once it is determined that an ad hoc survey is necessary, following an investigation phase, the Decision distinguishes between two types of surveys that may be used.<sup>51</sup> Type 1 surveys focuses on specific issues and usually aims to provide more detailed breakdowns within regular data collection exercises. These surveys may also cover datasets that give rise to (regular) data collection in a different context or by a different organisation, such as the IMF or the Bank of International Settlements (the BIS), and for which established methodological frameworks already exist. Type 2 surveys cover phenomena not previously analysed and for which no methodology has been established and no regular data collection is carried out. Type 2 is more time consuming and the information extracted from it may be more difficult to interpret in the process of systemic risk analysis.<sup>52</sup> The surveys can be conducted either by the relevant ESA or by the ESCB, in accordance with the ECB assessment following the investigation stage.<sup>53</sup> The data collection phase is illustrated in Diagram B striving to capture the detailed process in section 4 of the Decision.<sup>54</sup>

Finally, section 3 of Annex III outlines the principles that the ESRB Secretariat, the ECB and the ESAs will have to adhere to when fulfilling ad hoc information requests. These principles will ensure the necessary information will flow efficiently within confidentiality constraints. The principles are: (a) follow agreed procedural steps, which should be applied in transparent manner;<sup>55</sup> (b) avoid excessive interac-

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<sup>48</sup> The Decision, Annex III, paras 2.1 and 4.1.

<sup>49</sup> The Decision, Annex III, para. 2.2.

<sup>50</sup> The detailed procedure for the investigation phase and the data collection phase is outlined in section 4 of the Decision and is illustrated in Diagram B below.

<sup>51</sup> The Decision, Annex III, para. 2.1.

<sup>52</sup> Following the completion of an ad hoc survey the Decision provides for a quality check mechanism with a view to improving the effectiveness and efficiency of future surveys, The Decision, Annex III para. 4.2.4.

<sup>53</sup> The Decision, Annex III, paras 4.1.3.

<sup>54</sup> The Decision, Annex III, paras 4.2.2–4.2.3.

<sup>55</sup> For instance, the agreement between the ESRB and the ESAs on confidentiality procedures, see section 2 above on p 10.

tion with reporting agents; (c) maximise the use of existing information for various analytical and operational purposes, while respecting the necessary legal constraints and confidentiality safeguards; (d) use existing, to the extent possible harmonised, methodologies and data collections as much as possible; (e) develop best practices for ad hoc surveys by introducing feedback mechanisms and sharing information on methodologies among all parties involved.

It is interesting that the principles include neither requirements for the parties to endeavour to collect timely, accurate and comparable information nor a requirement for revaluation of the ESRB micro-prudential data needs. These essential features of the collected data and others are the subject of the next section.

### 3. Which Data Should be Collected by the ESRB?

The previous section outlined and evaluated the legal framework set out for the ESRB's data collection process. Yet, ensuring a strong legal framework that allows smooth flow of all relevant and necessary information for effective macro-prudential supervision does not guarantee the quality of that information. This section, therefore, set forth the main quality principles and elements that should guide the ESRB data collection and support effective conduct of macro-prudential supervision.<sup>56</sup> Generally, the data collected by the ESRB should be comprehensive but not overpowering, comparable, timely but accurate. In addition, the process of collecting the data should be an evolving process which preserves legal constraints of confidentiality.<sup>57</sup> These principles and elements can provide a benchmark for the ESRB staff in collecting and compiling data as well as enhance the credibility of the ESRB data analysis and policy decisions.

#### *Is there an Existing Data Quality Framework to Rely upon?*

There are numerous international and European frameworks which set out the main quality principles and elements guiding the production of data. These include the ECB's Statistic Quality Framework (the "ECB SQF") and the IMF's Data Quality Assessment Framework (the "IMF DQAF").<sup>58</sup> Deviations with respect to the precise content of the principles has been made here to reflect the different institutional setting and governance structure of the ESRB, the complex environment from

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<sup>56</sup> The reference here to data collection includes the process of collecting the data as well as the output (i.e. the collected data).

<sup>57</sup> See the ECB Statistics Quality Framework (hereinafter: 'the ECB SQF') <<http://www.ecb.int/pub/pdf/other/ecbstatisticsqualityframework200804en.pdf?21693e3edb0c4c0379e1d1ff5907f797>> accessed 10 November 2011.

<sup>58</sup> *Ibid.*, the IMF's Data Quality Assessment Framework <<http://dsbb.imf.org/Applications/web/dqrs/dqrsdqaf>> accessed 10 November 2011. See also the European Statistics Code of Practice <[http://epp.eurostat.ec.europa.eu/portal/page/portal/quality/code\\_of\\_practice](http://epp.eurostat.ec.europa.eu/portal/page/portal/quality/code_of_practice)> accessed 10 November 2011.



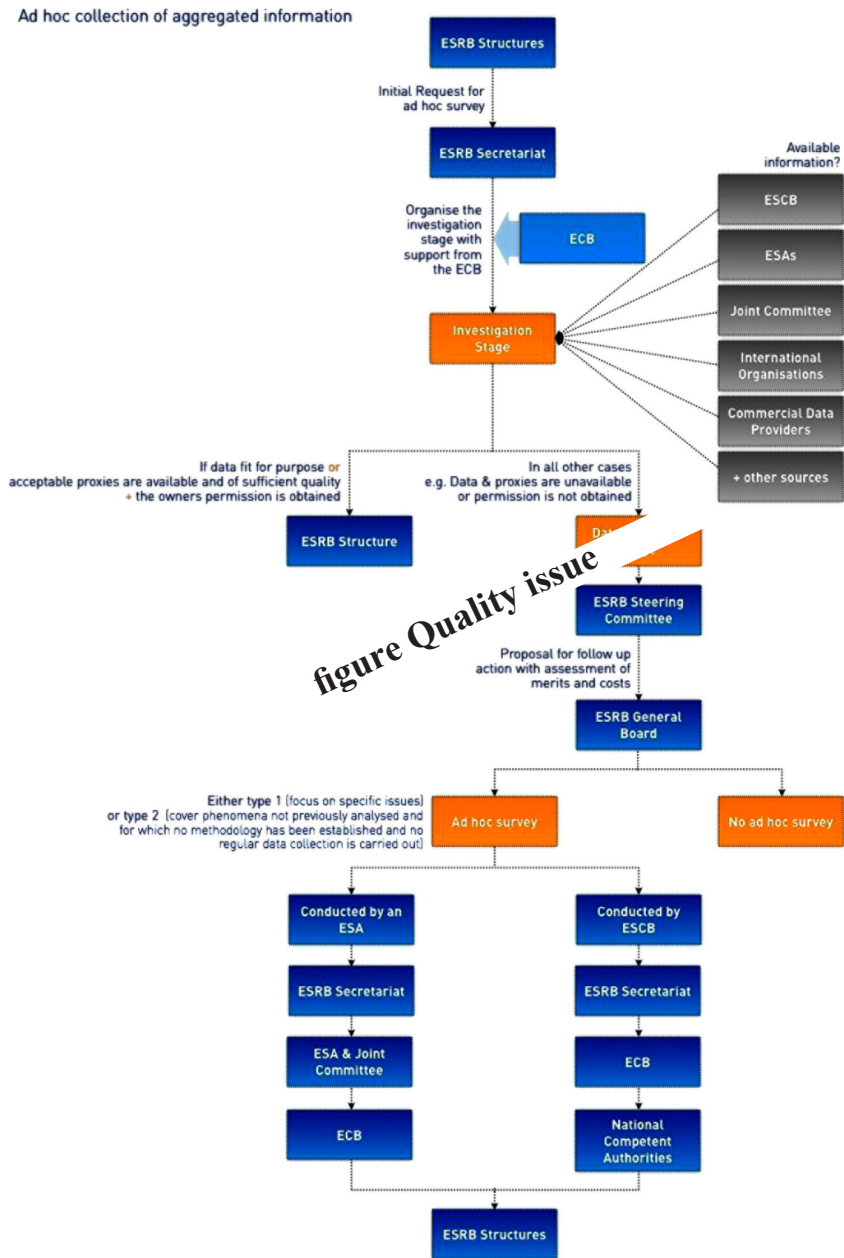


Diagram B

which data is being collected and the wide ranging areas on which data is being collected.<sup>59</sup> It is highly regrettable that no specific reference to any of these frameworks was incorporated in the Decision and that the principles that are set out in the Decision for ad hoc surveys data collection are not fully aligned with European or international standards regarding data quality.<sup>60</sup> Moreover, in the absence of guiding principles to be applied, quality assurance procedures, adjusted to the ESRB data collection process, cannot be laid out and followed. Given that data collection is one of the core tasks of the ESRB, it is suggested that this gap be rectified, either by amending the Decision and incorporating a reference to a data quality framework<sup>61</sup> or by setting specific principles and quality assurance procedures in a separate document which will form the ESRB's statement of intent in this area. The latter option is advisable since it will be tailored to the ESRB objectives and tasks.<sup>62</sup> For instance, the second principle of the ECB SQF requires a clear mandate for data collection, including the power to impose sanctions on reporting agents which fail to comply with their obligations. This requirement does not fit the governance of the ESRB that is based on 'comply or explain' mechanism.<sup>63</sup>

The outline of the essential principles and elements of high quality data in this context is subject to three important preliminary considerations. First, the ability of the ESRB to collect high quality data and analyse it depends on the availability of sufficient resources.<sup>64</sup> The ESRB Regulation does not prescribe a procedure for the establishment of the budget in contrast with the detailed procedure prescribed in the ESAs Regulations.<sup>65</sup> It is suggested, therefore, that the adequacy of costs should be monitored carefully and taken into account in the review of the ESRB mission and organisation, scheduled to take place in 2013.<sup>66</sup> Secondly, the quality of the ESRB data depends on the inputs received from various sources (such as, the ESAs and commercial data providers) as well as on the ESRB internal data collection process. This section focuses on the ESRB internal process, though the ESRB has a role in creating preconditions for high quality inputs from the various data sources. Ensuring these preconditions are in place and allow effective exchange of information is the subject of section 4.

Thirdly, the various quality principles are not necessarily confined to data collection activities, such as the principles requiring independence and accountability,

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<sup>59</sup> Section 4 of this Article will outline the various data sources and the unique challenges they present in the data collection process.

<sup>60</sup> For the principles for ad hoc survey data collection set in the Decision see section 2 above on pp 15–16.

<sup>61</sup> It is suggested that the European Statistic Code of Practice or the IMF DQAF are more suitable here than the ECB SQF due to their generic application.

<sup>62</sup> As laid down in Art. 2 of the ESRB Regulation.

<sup>63</sup> The ESRB Regulation, Art. 17.

<sup>64</sup> The ECB SQF, Principle 6.

<sup>65</sup> Arts 62–63 of the EBA Regulation. According to the ESRB Annual Report 2011, p 17 the direct costs amounted to €7.1 million, to which indirect costs relating to other support services shared with the ECB, such as human resources, IT and general administration, have to be added.

<sup>66</sup> The ESRB Regulation, Art. 20.

impartiality and objectivity.<sup>67</sup> These general principles have been ensured, though not without criticism in the ESRB Regulation and can be applied to the ESRB's operation in the context of data collection as well.<sup>68</sup>

### *The Meaning of 'High Quality' Data*

In order to lay out the main quality principles and elements guiding rigorous macro-prudential data collection it is vital to define 'quality'. This is not an easy task as quality is inherently a subjective notion.<sup>69</sup> In statistics, high quality can be tested by asking whether the collected data and the collection process are fit for purpose.<sup>70</sup> It is submitted that fit for purpose in the context of the ESRB data collection is not limited to fulfilling the ESRB objectives as set out in Art. 2 of the ESRB Regulation. It is a much wider concept interpreted to encompass how well the expectations of the key stakeholders are fulfilled. The key stakeholders in this context should not be confined to the internal users within the ESRB that are involved in the data collection process. It should be interpreted to include 'outsiders', such as the various data sources through which data is being transferred to the ESRB and reporting agents from which data is being collected.<sup>71</sup> Accordingly, safeguarding confidentiality and minimising burden on reporting agents form part of the principles outlined below.

### *Comprehensive but not Excessive*

It is clearly vital that the ESRB will collect all the relevant information to identify systemic risks to financial stability however it needs to avoid the pitfall of collecting too much information.

First, "over collecting" information may result in missing the forest for the trees and will become non-effective method of collection of information.

Secondly, a cost-effective approach should be taken to avoid duplication of efforts, since existing statistics are already being collected by the ESS and by the ESCB. Indeed, as discussed in section 2 above, the ESRB Regulation provides that the measures of collection of information should be taken without prejudice to the legal

<sup>67</sup> For instance, The ECB SQF, Principles 3 and 4.

<sup>68</sup> On the governance of the ESRB see Ch. 2 of the ESRB Regulation and in particular Art. 4–5 of the ESRB Regulation; On impartiality requirement see Art. 7 of the ESRB Regulation; On accountability see Art. 19 of the ESRB Regulation. For criticism on the governance and accountability arrangement of the ESRB see Miriam Goldby and Anat Keller, *The Commission's Proposal for an New European Systemic Risk Board: An Evaluation* 4 Law and Financial Markets Review 48–57 (2010).

<sup>69</sup> The ECB SQF, para. 2.1.

<sup>70</sup> This term has been used in the Decision in determining the need to conduct an ad hoc survey. It is to be noted the ECB SQF refers to the quality in the context of the institutional environment, the statistical processes and the statistical outputs.

<sup>71</sup> For the various data sources (such as, the ESAs and commercial data providers) see section 4 below, reporting agents are the financial institutions subject to reporting obligations.

framework of the ESS in the field of statistics.<sup>72</sup> Article 15(4) ensures that before requesting information from the ESAs the ESRB will take account of existing statistics produced, disseminated and developed by the ESS and the ESCB. In addition, the third principle of the Decision requires the ESRB Secretariat, the ECB and the ESAs to maximise the use of existing information and the investigation phase outlined above involves examining the available information with international institutions, such as the IMF and the BIS, before proceeding to conduct an ad hoc survey. For this arrangement to function, the ESRB will have to finalise agreements with these institutions relating to the exchange of information and in particular the confidentiality regime to be applied.<sup>73</sup>

Thirdly, ensuring non-excessive data collection will result in reduced burden on reporting agents and accordingly will be aligned with the 'fit for purpose' requirement.

Finally, there is no consensus on how detailed the information collected for the purpose of conducting macro-prudential analysis needs to be. While more granular data enable better analysis, the compilation and the sharing of the information become more difficult.<sup>74</sup> Compilation is more difficult because of possible lack of comparability of the data and sharing of information is more difficult because more granular data potentially raise concerns over confidentiality.<sup>75</sup> The Decision is the ESRB's first attempt to tackle this challenge via the granularity rule of thumb and as suggested this rule may need to be reevaluated and adjusted in times of crisis, when more granular information may be required.<sup>76</sup>

### *Comparable*

Comparability of data is critical across Member States, across sectors (going beyond the banking sector, including other major financial institutions such as insurance companies and hedge funds), across financial products and ultimately across global markets.<sup>77</sup> Both the de Larosière group and the Issing Committee recommended the creation of an international risk map that will compromise all

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<sup>72</sup> The ESRB Regulation, Art. 15(4) referring to Council Regulation (EC) 223/2009 on European Statistics [2009] OJ L87/164 and to Council Regulation (EC) 2533/98 concerning the Collection of Statistical Information by the European Central Bank [2008] OJ L318/8.

<sup>73</sup> This will be done in accordance with Art. 28 of the Decision of the European Systemic Risk Board of 20 January 2011 adopting the Rules of Procedures of the European Systemic Risk Board (ESRB/2011/1) OJ C58/4.

<sup>74</sup> Stephan Cecchetti, Ingo Fender and Patrick McGuire, *Toward a Global Risk Map* (2010) BIS Working Papers No 309 <<http://www.bis.org/publ/work309.htm>> accessed 10 November 2011.

<sup>75</sup> FSB and IMF, *The Financial Crisis and Information Gaps, Implementation Progress Report* (June 2011) <<http://www.imf.org/external/np/g20/pdf/063011.pdf>> accessed 10 November 2011, p 24.

<sup>76</sup> See section 2 above on p 12.

<sup>77</sup> FSB and IMF, *Information Gaps Report* (2009) (n 4) and *Implementation Progress Report* (2011) (n 4) that sets the task of harmonising data collections from G-20 economies in high priority over 2011.

these elements.<sup>78</sup> The suggested risk map would include common data base with all the needed information for identifying systemic risks on a global scale. Until this utopia is reached the ESRB will have to ensure that it uses, to the extent possible, harmonised methodologies and data collection.<sup>79</sup> The ESAs will play a central role in achieving comparability of micro and macro information within the EU as they are responsible for creating and updating common reporting templates for their sectors.<sup>80</sup>

### *Timely but Accurate*

The financial crisis has revealed the need to ensure the timeliness of the information being collected. Data, which could have been useful in monitoring events during the crisis, was available with a lengthy time lag.<sup>81</sup> This means that information should be collected by the ESRB regularly at short intervals and, where necessary, and in particular during times of crisis, on an ad hoc basis. While timely provision of data to the ESRB is vital to detect systemic risks upon their emergence, the ESRB will also have to strike the right balance between data timeliness and its accuracy.<sup>82</sup> On the one hand, rushed false alarms will damage the credibility of the ESRB and therefore will jeopardise its effective operation and on the other hand, tardy responses will defeat the purpose of establishing such an institution.

### *Evolving Framework*

EU and global Markets respond to technological developments and regulatory initiatives and continuously adapt and innovate. Therefore, the task of collecting information is a dynamic one and addressing information gaps is not a one-off exercise.<sup>83</sup> The ESRB should aim to adapt its collection efforts rapidly and identify new areas

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<sup>78</sup> The de Larosière Report (n 13), Recommendation 27; The Issing Committee, *New Financial Order* (London, 2 April 2009) (hereinafter “the Issing Committee”), para. 2.

<sup>79</sup> The Decision, Annex III, s 3(d).

<sup>80</sup> See for instance, the EBA Regulation, Art. 29(1)(c). For a more detailed discussion of harmonisation of the reporting rules see section 4 below on p 36.

For achieving global comparability see FSB, *Understanding Financial Linkages: The Common Reporting Template for Global Systematically Important Banks* (October 2011) <[http://www.financial-stabilityboard.org/publications/r\\_1111006.pdf](http://www.financial-stabilityboard.org/publications/r_1111006.pdf)> accessed 10 November 2011.

<sup>81</sup> FSB and IMF, *Information Gaps Report* (2009)(n 4). Data provided in a timely manner means that it is made available to policy makers in time to be used in making decisions. A related requirement is the punctuality of the data that refers to the time lag between the scheduled and the actual release of data. See the ECB SQF, Principle 12.

<sup>82</sup> The trade-off between timeliness and accuracy is a well debated issue, e.g., ECB, *Trade-off between Timeliness and Accuracy, ECB Requirements for General Economic Statistics* (15 March 2001) <<http://dsbb.imf.org/vgn/images/pdfs/bierahnert.pdf>> accessed 10 November 2011.

<sup>83</sup> ‘Can Policymakers Fill the Gaps in Their Knowledge About the Financial System?’ *The Economist* (13 Jan 2011) <[http://www.economist.com/node/17900268?story\\_id=17900268&fsrc=rss](http://www.economist.com/node/17900268?story_id=17900268&fsrc=rss)> accessed 10 November 2011.

where information is needed, needed more frequently or needed in a different form.<sup>84</sup> The importance of certain data sets will change over time and there will be a need to introduce new data sets. Aiming at moving targets and hitting the red bull's eye in time will be one of the most challenging tasks of the ESRB. It will have to keep track of new complex areas that may contain systemic threats to the financial system. The most prominent example of this, at present, is the market for Exchange-Traded Funds (ETFs) and synthetic ETFs in particular. These markets have expanded widely over the last 10 years<sup>85</sup> and the current estimation suggests that the value of the European ETF market exceeds US\$300 billion.<sup>86</sup> However, a combination of lax regulatory supervision in this area, complexity of the products and lack of transparency make this area fertile ground for systemic risks. ETFs have not escaped the scrutiny of major international institutions (the FSB, IMF and the BIS) and regulators such as the SEC and the ESRB. The IMF and BIS have recently published reports warning of the systemic risks that these products can impose on the global financial system.<sup>87</sup> The ESMA quickly followed by initiating a public consultation on these products and the ESRB gave its response, encouraging the taking of measures to mitigate systemic risks in this area.<sup>88</sup>

### *Confidentiality*

Confidentiality creates confidence and this, in turn, brings cooperation in sharing of information. Without satisfactory confidentiality arrangements Member States

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<sup>84</sup> FSB, IMF and BIS, *Macroprudential Policy Tools and Frameworks – Update to the G-20 Finance Ministers and Central Bank Governors* (14 February 2011) <[http://www.financialstabilityboard.org/publications/r\\_1103.pdf](http://www.financialstabilityboard.org/publications/r_1103.pdf)> accessed 10 November 2011; FSB, IMF and BIS, *Macroprudential Policy Tools and Frameworks – Progress Report* (27 October 2011) <[http://www.financialstabilityboard.org/publications/r\\_111027b.pdf](http://www.financialstabilityboard.org/publications/r_111027b.pdf)> accessed 10 November 2011.

<sup>85</sup> The ESRB Response to the ESMA Discussion Paper on *Policy Orientation and Guidelines for UCITS Exchange-Traded Funds and Structured UCITS* (21 September 2011) <[http://www.esrb.europa.eu/pub/pdf/ESRB\\_response\\_to\\_ESMA\\_consultation\\_exchange\\_traded\\_funds.pdf?02bbca4814f016d73b1650196e62adc9](http://www.esrb.europa.eu/pub/pdf/ESRB_response_to_ESMA_consultation_exchange_traded_funds.pdf?02bbca4814f016d73b1650196e62adc9)> accessed 10 November 2011.

<sup>86</sup> Jean-Claude Trichet and Mervyn King, Andrea Enria, *Introductory Statement to the ESRB Press Conference* (Frankfurt, 22 June 2011).

<sup>87</sup> IMF, *Global Financial Stability Report, Durable Financial Stability Getting There from Here* 68–72 (April 2011); Srichander Ramaswamy, *Market Structures and Systemic Risks of Exchange-Traded Funds* (2011) BIS Working Papers No 349; Harold Bradely and Robert E Litan, Kaufmann Foundation, *Chocking the Recovery: Why New Growth Companies Aren't going Public and Unrecognised Risks of Future Market Disruptions* (8 November 2010) <[http://www.kauffman.org/uploadedFiles/etf\\_study\\_11-8-10.pdf](http://www.kauffman.org/uploadedFiles/etf_study_11-8-10.pdf)> accessed 10 November 2011; 'Exchange-Traded Funds, Too Much of a Good Thing, the Risk Created by Complicating a Simple Idea' *The Economist* (23 June 2011) <<http://www.economist.com/node/18864254>> accessed 10 November 2011.

<sup>88</sup> The ESMA Discussion Paper on *Policy Orientation and Guidelines for UCITS Exchange-traded Funds and Structured UCITS*, ESMA/2011/220, 22 July 2011; The ESRB response to the ETFs Consultation Paper September 2011 (n 76) suggesting looking into the possibility of withdrawing the UCITS label from such products. Attempts to limit the information gap in this area are under way thorough conduct of ad hoc surveys, see Vítor Constâncio, *How Fit are Statistics for Use in Macro-prudential Oversight?* (The Sixth ECB Statistics Conference, Frankfurt am Main, 17 April 2012).

will not be willing to share information about local institutions that are experiencing difficulties, for fear that the information will be leaked and impact market confidence. Consequently, the ESRB Regulation, The ECB Regulation and the ESAs Regulation provide the necessary legal framework for safeguarding the confidentiality of the information being shared albeit with several concerns as discussed before<sup>89</sup>. The ESRB will need to ensure that these will not be an obstacle for smooth flow of information by setting up and ensuring the strict observance of specific confidentiality arrangements and procedures with the ESAs and the national central banks as well as with international institutions and third countries.

Ensuring that data collected by the ESRB is of high quality and complies with the characteristics outlined above would be the first hurdle to overcome towards effective macro-prudential supervision. Yet, another hurdle is ensuring that this data reaches the ESRB on a timely basis and that any obstacles to the smooth flow of information, both legal and practical, are removed. The subsequent section elaborates on the sources of data and the mechanisms by which data is passed on to the ESRB from these sources and highlights possible obstacles identified in this process.

#### 4. Which Data is being Collected by the ESRB?

##### *The Various Sources from which the ESRB collects its Data and the Possible Obstacles to smooth Flow of Information*

Outlining which data is actually being collected by the ESRB is a tricky challenge. The ESRB has been in operation for two years, a relatively short period and there is limited amount of publicly available evidence about the data collection process in general and about the sources from which this data is being collected, in particular. The data which is being collected by the ESRB for macro-prudential oversight of the financial system within the EU is termed here the ‘information base’ of the ESRB. The ‘information base’ comprises available data provided by the ECB and international institutions; micro-prudential information provided by the ESAs; market data from commercial data providers and other data sets and market intelligence from private stakeholders.<sup>90</sup> The data retrieved from these sources will be the starting point of the ESRB macro-prudential analysis, which eventually may lead to issuance of early warnings and policy recommendations for remedial action when significant systemic risks emerge. The ESRB can be described here as a central hub, pooling datasets from various sources and connecting them together to create a constantly changing systemic risk map within the EU.

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<sup>89</sup> The ESRB Regulation, Art. 8; The ECB Regulation, Art. 6 and the EBA Regulation, the ESMA Regulation and the EIOPA Regulation, Art. 70, respectively. See section 2 above for several concerns raised regarding these provisions.

<sup>90</sup> Jean-Claude Trichet, *Introductory Statement, Hearing on the ESRB before the Committee on Economic and Monetary Affairs of the European Parliament* (7 February 2011) <<http://www.esrb.europa.eu/news/pr/2011/html/sp110207.en.html>> accessed 10 November 2011.



Each one of these sources presents unique challenges and possible obstacles to the smooth flow of information to the ESRB. The possible obstacles can be identified in the legal framework within which the ESRB interacts with these data sources as well as in the mechanism by which information is being exchanged with them.

### *Existing Data and its Enhancement*

The ESRB does not operate in a vacuum. The European and international arenas are crowded with institutions and central banks aimed at ensuring financial stability and identifying and addressing vulnerabilities in financial markets, either as a main objective or as a collector of data that can be utilised for macro-prudential analysis. The ECB, the FSB, the IMF and the BIS are just a few. This section notes that a significant amount of information is already being collected by these institutions and provides a considerable share of the data needed for macro-prudential analysis. This type of information can be referred to as the 'existing supply'<sup>91</sup> and it originates from the ECB, the ESCB and other international institutions. Clearly, post-crisis the 'existing supply' is being enhanced to tailor more accurately the global macro-prudential needs and where appropriate, the specific needs of the ESRB. Notably, the 'existing supply' of the ESRB is supplemented by other data sources to ensure a robust information base.

### *Existing Data from the ECB*

When considering the establishment of the ESRB, the European Council recognised the need to rely on an existing framework, exploiting already available information at the disposal of central banks.<sup>92</sup> The ECB, in cooperation with national central banks, compiles and disseminates a wide range of monetary statistics and indicators regarding financial institutions. Together with the Eurosystem it monitors developments in the euro area and the EU banking sector as well as in other financial sectors to assess the possible vulnerabilities in the financial sector and its resilience to potential shocks.<sup>93</sup> Nonetheless, risk assessments conducted by central banks were generally not made with the specific aim of suggesting concrete remedial prudential policy or regulatory action and therefore their recommendations were outlined in broad terms and the discussion of the risks in the public sphere tended to be mostly of a qualitative nature.<sup>94</sup> By contrast, the ESRB is expected to collect

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<sup>91</sup> Vitor Constâncio, *Information Requirements for Macro-prudential Oversight and the Role of Central Banks* (The Fifth ECB Conference on Central Bank Statistics: What Did the Financial Crisis Change?, Frankfurt, 19–20 October 2010) <<http://www.ecb.int/press/key/date/2010/html/sp101020.en.html>> accessed 10 November 2011.

<sup>92</sup> European Commission, *Proposal for a Regulation of the European Parliament and of the Council on Community Macro Prudential Oversight of the Financial System and Establishing a European Systemic Risk Board* COM (2009) 499 final, para. 6.2.2.

<sup>93</sup> *Ibid.*, para. 6.1.

<sup>94</sup> Charles AE Goodhart, *The Macro-Prudential Authority: Powers, Scope and Accountability* 2 OECD Journal: Financial Market Trends 5 (2011).

information that will allow it to form a deeper understanding of the potential magnitude of the risks, the interconnections within the financial system and between the financial system and the real economy. Furthermore, in order to produce concrete policy suggestions in the prudential and regulatory area, its analysis will have to be more precise, involve quantitative assessments and clear risk prioritisation.<sup>95</sup> Yet, given the ECB expertise and in-depth knowledge on macro-prudential issues its involvement is essential and it plays an important and central role in the new financial supervisory architecture.<sup>96</sup> The ECB ‘ensures’ the ESRB Secretariat and provides analytical, statistical, logistical and administrative support to the ESRB<sup>97</sup>. The missions of the Secretariat include, in particular, the collection and processing of information on behalf and for the benefit of the fulfilment of the ESRB tasks<sup>98</sup> and accordingly, confidential statistical information collected by the ECB is to be shared with the ESRB.<sup>99</sup> The linkage between the ESRB and the ECB is strengthened by the fact that the ECB’s President and Vice President serve on the General Board of the ESRB.<sup>100</sup> Taking on this central role in the functioning of the ESRB,

<sup>95</sup> Vitor Constâncio (n 91).

On macro-prudential analysis information needs see Lorenzo B Smaghi, *Macro-prudential Supervision* (The CEPR/ESI 13th Annual Conference on “Financial Supervision in an Uncertain World”, European Banking Centre at Venice International University, Venice, 25–26 September 2009) <<http://www.bis.org/review/r090929e.pdf?frames=0>> accessed 10 November 2011.

<sup>96</sup> This is not without criticism; see for instance Williem Buiter (n 36).

<sup>97</sup> The ECB Regulation, Arts 2 and 3, the ESRB Regulation, Art. 4(4).

By conferring upon the ECB specific tasks related to prudential supervision the Council implemented for the first time Art. 105(6) of the Treaty on European Union [1992] OJ C191/01 (hereinafter the EU Treaty), acting unanimously on a proposal from the Commission and after consulting the ECB and receiving the assent of the European Parliament.

For difficulties in relying on Art. 105(6) of the EU Treaty as the legal basis for entrusting the ECB with specific tasks see Jane Welch, Written evidence to the Treasury Committee on the Proposals for European Financial Supervision (13 November 2009) <<http://www.publications.parliament.uk/pa/cm200910/cmselect/cmtreasy/37/37we04.htm>> accessed 10 November 2011. First, Art. 105(6) specifies that the Council can confer specific tasks on the ECB “with the specific exception of insurance undertakings”. This unambiguous wording makes it difficult to see how the ECB can be entrusted by the ESRB with the task of collecting information about insurance undertakings for the specific purpose of improving macro-prudential supervision. But see Lorenzo Bini Smaghi, *Financial Crisis: Where Does Europe Stand?* (2009 ECON meeting with national parliaments, Brussels, 12 February 2009). Secondly, both the ESRB Regulation (para. 31 of the Preamble) and the ESAs Regulations (see for instance, the EBA Regulation para. 17 of the Preamble) are based on Art. 95 of the EU Treaty (now Art. 114 of the Treaty on the Functioning of the European Union (TFEU) which is designed to facilitate the establishment and functioning of the internal market. These measures are “EEA relevant” and would normally apply in due course to the European Economic Area (EEA) EFTA (European Free Trade Association) states – Norway, Iceland and Lichtenstein. However, the EEA Agreement does not cover participation in economic and monetary union and accordingly EEA states are not bound by the monetary policy provisions of the EU Treaty (including Art. 105).

<sup>98</sup> The ECB Regulation, Art. 5(1).

<sup>99</sup> The ESRB Regulation, Art. 15(4).

<sup>100</sup> With voting rights, the ECB Regulation, Art. 6. Furthermore, for the first five years the President of the ECB will be the Chair of the ESRB. For the subsequent terms, the Chair of the ESRB shall be designated in accordance with the modalities determined on the basis of the review provided for in

the ECB stated on many occasions that it is working to make improvements in its statistical bases in order to support the data needs of ESRB<sup>101</sup> and one of the prominent initiatives in this regard is the enhancement the Consolidated Banking Data (CBD).<sup>102</sup> The ECB recognised that the major gap in its current available statistics is the lack of information on the inter-linkages within the financial system (including exposures between institutions in the banking sector and institutions in non-regulated markets).<sup>103</sup> The ESRB is challenged to bridge this gap and include in its information base data on interconnections in the financial system in order to support concrete policy recommendations. It can be expected that in the next few years the ECB will receive from the ESRB relatively frequently new data requests that will translate into ad hoc surveys.<sup>104</sup> Such surveys will enable the ESRB to retain flexibility in order to meet changing data needs, which reflect innovation and emergence of new areas with systemic impact in financial markets. Eventually, these data requirements will form part of the regular supervisory and statistical data that are comparable across Member States and across institutions and will be disclosed to the ESRB on a regular basis.<sup>105</sup>

Finally, it is to be noted that the ECB monitors developments in the euro area and in order to ensure that data on non eurozone countries is comprehensive, regular provision of information by the ESCB should take place. Regular exchange of information with the ESCB is enshrined in the ESRB Regulation and the mechanism for ad hoc surveys conducted by the ESCB is set out in the Decision.<sup>106</sup> Yet, as already been discussed in section 2, the Decision does not provide the necessary detailed arrangements for regular provision of aggregated information by the ESCB. The Decision sets out in Annex I the mechanism for the regular provision of aggregated information by the ECB, while information on non-eurozone countries is to be provided to the ESRB so far it is made available to the ECB on a voluntary basis.

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Art. 20 (The ESRB Regulation, Art. 5(1)). Still, the ECB made it clear that the ESRB is a distinct and separate body from the ECB and that it will not change in any way the mandate and the functioning of the ECB's statutory role, see for instance, Jean-Claude Trichet, *Macro-prudential Regulation as an Approach to Contain Systemic Risk: Economic Foundations, Diagnostic Tools and Policy Instruments* (13th conference of the ECB-CFS Research Network, Frankfurt, 27 September 2010) <<http://www.ecb.int/press/key/date/2010/html/sp100927.en.html>> accessed 10 November 2011.

<sup>101</sup> Vitor Constâncio (n 91), pt 3; Peter Praet (n 1), para. 3.2.

<sup>102</sup> The CBD is a set of data that provides various statistics about the EU banking system on consolidated basis and is published by the ECB on a semi-annual basis.

Anna Maria Agresti, Stephano Borgioli and Paolo Poloni, *Enhancement of ECB Statistics for Financial Stability Analysis* 18 (the Fifth Irving Fisher Committee Conference, Frankfurt, November 2011), <http://www.bis.org/ifc/publ/ifcb34.pdf> > accessed 10 November 2011.

See also Vitor Constâncio (n 91) on other available ECB datasets that can be utilised for macro-prudential analysis, such as the euro area financial accounts and the surveys on the access to finance of small and medium-sized enterprises in the euro area and the EU.

<sup>103</sup> Jürgen Stark, *Central Banks Statistics: What did the Financial Crisis Change?* (The Fifth ECB Conference on Statistics, Frankfurt, 20 October 2010).

<sup>104</sup> *Ibid.*

<sup>105</sup> Vitor Constâncio (n 91).

<sup>106</sup> The ESRB Regulation. Art. 15(4).

*Existing Data from International Institutions*

The financial crisis has demonstrated the global nature of systemic risks. A comprehensive assessment of systemic risks will need to take into account any global developments in financial markets. In this respect cooperation is needed between the ESRB and other international institutions, such as the IMF and the FSB. Various data and statistics provided by these institutions are publicly available and can be easily accessed.<sup>107</sup> For data which is not publicly available, the ESRB will need to finalise, in the near future, agreements relating to the exchange of information and in particular the confidentiality regime to be applied.

*The IMF and the FSB – Exploring and Closing Global Information Gaps*

The IMF has functioned for more than 60 years, but since its establishment its membership has widened and its operation, structure and governance has considerably evolved along with the global economy. The IMF is mandated to oversee the international monetary system and monitor the economic and financial policies but it also plays a role in the surveillance of the financial sector and strengthening the global financial stability.<sup>108</sup> This latter role is exercised through initiatives such as the Financial Stability Assessment Program (FSAP), collection and dissemination of the IMF's Financial Soundness Indicators (FSIs), encouraging greater disclosure of FSIs through the Co-ordinated Compilation Exercise (CCE) and regular bilateral and multilateral surveillance often reported in the IMF's Global Financial Stability Report (GFSR). The IMF is making progress in developing macro-prudential frameworks and sharpening its risk assessments to identify build up of vulnerabilities.<sup>109</sup> The new product of the Consolidated Spillover Report signals the efforts of the IMF to focus on linkages between sectors and countries making its surveillance as interconnected as the global economy.<sup>110</sup>

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<sup>107</sup> Such as the World Economic Outlook. For other data sets and statistics see <<http://www.imf.org/external/data.htm>> accessed 10 November 2010.

<sup>108</sup> Articles of Agreement of the IMF, Arts 1 and 4; John Palmer and Yoke Wang Tok, *The Triennial Surveillance Review—External Study-IMF and Global Financial Stability* (25 July 2011) (hereinafter the TSR), para. 15; The TSR notes that the IMF, in many ways, is already playing an overreaching role of a global financial stability advisor though there are still legal, operational and other limitations to exercising this role efficiently. This possible expansion of the IMF mandate is outside the scope of this Article. For the limitations in the IMF multilateral surveillance mandate under Art. IV see the IMF, *The Fund's Mandate—An Overview* (January 2010).

<sup>109</sup> GFSR (September 2011), Chapter 1.

<sup>110</sup> On the FSAP see the Independent Evaluation Office (IEO), *Report on the Evaluation of the Financial Sector Assessment Program* (5 January 2006); On FSIs and CCEs see Owen Evans and others, *Macro Prudential Indicators of Financial Soundness* IMF Occasional Paper 192 (2000) <<http://www.imf.org/external/pubs/ft/op/192/op192.pdf>> accessed 10 November 2011; Comprehensive information on the FSIs can also be found at <http://fsi.imf.org>; On Consolidated Spillover Report see IMF, *Consolidated Spillover Report – Implications from the Analysis of the Systemic-5* (11 July 2011) <<http://www.imf.org/external/np/pp/eng/2011/071111.pdf>> accessed 10 November 2011.

The IMF works alongside the FSB which was established by the Group of Twenty (G-20) Heads of State in April 2009 with a mandate to promote global financial stability.<sup>111</sup> The FSB consists of national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.<sup>112</sup> It assesses vulnerabilities affecting the financial system, identifies and oversees action needed to address them and in collaboration with the IMF is responsible for Early Warning Exercises (EWEs). Furthermore, the FSB is mandated to promote cooperation and information exchange between authorities responsible for financial stability.<sup>113</sup> Based on this mandate the FSB was called on by the G-20 Finance Ministers and Central Bank Governors in April 2009 to explore, together with the IMF, information gaps and provide proposals for strengthening data collection. The joint report, “The Financial Crisis and Information Gaps”, which included 20 recommendations, was endorsed at the meeting of the G-20 finance ministers and central bank governors in November 2009. The report identified data gaps in assessing the build-up of risks in the financial sector, understanding international network connections, and monitoring vulnerabilities of domestic economies to shocks. It made recommendations to close these gaps and to improve the communication of official statistics. The FSB is monitoring the progress in the implementation of these recommendations and at the time of writing, already published two progress reports in 2010 and 2011.<sup>114</sup> The 2011 progress report outlines the significant progress that has already been made to close identified data gaps. For instance, the progressing work of the FSB on a common reporting template for global systemically important financial institutions (G-SIFIs) will improve consistency in the collection and sharing of data on the interconnectedness and common exposures of these institutions.<sup>115</sup> This only forms part of further post-financial crisis data enhancement of the BIS and the IMF statistics, providing more granular information and more frequent reporting to meet macro-prudential needs.<sup>116</sup>

<sup>111</sup> ‘Declaration on Strengthening the Financial System’ (London Summit, 2 April 2009)

The FSB is successor to the Financial Stability Forum (FSF) which was founded on the 20th February 1999 by the Finance Ministers and Central Bank Governors of the Group of seven at a meeting in Bonn.

<sup>112</sup> Current members are listed in Annex A of the FSB Charter available on the FSB website <<http://www.financialstabilityboard.org/>>. In September 2010, the IMF became a member of the FSB.

<sup>113</sup> The FSB Charter, Art. 2.

<sup>114</sup> A follow-up report was provided to G-20 Ministers and Governors in June 2010 followed by an updated progress report in June 2011.

<sup>115</sup> FSB, *Consultation Paper – Understanding Financial Linkages: a Common Data Template for Global Systemically Important Banks* (6 October 2011) <[http://www.financialstabilityboard.org/publications/r\\_111006.pdf](http://www.financialstabilityboard.org/publications/r_111006.pdf)> accessed 10 November 2011; Adelheid Burgi-Schmelz and others, *Enhancing Information on Financial Stability* (The Irving Fisher Committee Conference, Basel, August 2010) <<http://www.bis.org/ifc/events/5ifcconf/burgi.pdf>> accessed 10 November 2011.

<sup>116</sup> Other initiatives mentioned in the *Progress Report – The Financial Crisis and Information Gaps* (June 2011) include enhancement of the Bank for International Settlements (BIS) International Banking Statistics (IBS) data to provide more granular information on a nationality basis; Enhancement and increase of frequency of reporting of data on cross-border security holding in the IMF’s Coordinated

The ESRB's key challenge is to integrate these data in its own information base by cooperating closely with these international players.<sup>117</sup> This can be described as a two side cooperation: in one direction, international institutions will receive more granular data on the EU financial system that will enhance their own information base,<sup>118</sup> and, in the other direction, the ESRB will be able to fit the data collected within the ESFS in the world jigsaw and get a clearer picture of emerging risks in the financial system within the EU.

The brief statement in the ESRB first 2011 annual report that it began to foster working relations with various international institutions and bodies, such as the Financial Stability Oversight Council (the FSOC) is somewhat disappointing. The 2011 Annual Report of the FSOC does not address at all the international cooperation with its parallel institution in the EU and reinforces the impression of a slow progress in this aspect.

### *Micro-prudential Information provided by the ESAs*

In order to produce high quality macro-prudential analysis the ESRB needs to draw from both top-down and bottom-up analysis. A top-down analysis focuses on aggregate macro-financial data, and is performed in order to monitor vulnerabilities and assess conditions in specific sectors with possible implications for system-wide risks. It can broadly identify areas of potential systemic risk, indicating where more detailed and granular analysis is needed.<sup>119</sup> The 'existing supply' of the ECB and other international institutions statistics forms the basis for this analysis. Bottom-up analysis, on the other hand, relies on micro-level or firm-specific data that is then aggregated to produce sectoral or system-wide assessments.<sup>120</sup> Micro-prudential data provided by the ESAs forms the basis for conducting bottom-up analysis and ultimately for forming a bird's eye view of the financial system in the EU. Yet, the channels of information between the ESRB and each one of the ESAs are not free from obstacles.<sup>121</sup>

It has been seen in section 2 that concerns exist regarding the aggregate regular flow of information between the ESRB and the ESAs as set out in the Decision.

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Portfolio Investment Survey (CPIS) and Continuing work of the IMF to increase number of countries disseminating Financial Soundness Indicators (FSIs), increasing the frequency of the reporting and reviewing the FSIs list.

<sup>117</sup> The ESRB Regulation, Art. 2(i). In the ESRB Annual Report 2011, p 12.

<sup>118</sup> Art. 9(4) of the ESRB Regulation permits, where appropriate, high-level representatives from international financial organisations carrying out activities directly related to the tasks of the ESRB to be invited to attend the meetings of the ESRB General Board.

<sup>119</sup> Vitor Constâncio (n 91), part 3.

<sup>120</sup> Vitor Constâncio (n 91), part 3.

<sup>121</sup> The IMF, *Lessons from the European Financial Stability Framework Exercise* (2011) Country Report No. 11/186 <<http://www.imf.org/external/pubs/ft/scr/2011/cr11186.pdf>> accessed 10 November 2011. According to this recent IMF report, whereas the EBA has indicated it will have access to all confidential data available to national supervisors on a regular basis, reportedly the EIOPA and the ESMA are facing opposition in their efforts to obtain all the necessary data (The IMF Country Report, para. 57).



Obstacles may also exist when the ESRB requests from the ESAs data on individual institutions (not in aggregate or summary form). The ESRB Regulation allows the exchange of such information only on an ad hoc basis, following proportionate and justified request considering the prevailing market situation.<sup>122</sup> On the one hand, this mechanism restricts the ESRB's access to sensitive micro-prudential data and may give rise to problems in practice, for example, if it is necessary to compare bank-specific data over time on a systematic basis.<sup>123</sup> On the other hand, it is essential to ensure confidentiality of such sensitive information, particularly due to the broad range of parties involved in the ESRB's governance structure that arguably may increase the risk of leakages. In order to ensure a smooth exchange of non-aggregate information the ESRB needs to establish guidelines with the ESAs outlining criteria for handling such "reasoned" requests.<sup>124</sup> It is suggested that these guidelines could form part of the Decision alongside the aggregated ad hoc requests and be subject to the principles outlined in section 3 of Annex III of the Decision, including safeguarding confidentiality.<sup>125</sup>

The smooth flow of information to the ESRB depends not only on open channels between the ESRB and the ESAs but also on open channels between the ESAs and national supervisors and financial institutions. Article 35 of the EBA Regulation, the ESMA Regulation and the EIOPA Regulation, respectively set out the way the relevant ESA will collect information for its supervisory tasks in line with Art. 15 of the ESRB Regulation. The respective ESA is to first take into account any relevant existing statistics at the EU level, then request data from national supervisors and if information is still not available or not available in a timely manner request the information from the Member States' other public bodies. Only as a last resort and upon a duly justified and reasoned request is the ESA allowed to request data directly from individual financial institutions.

The information sharing between the ESAs and the national supervisors is done, *inter alia*, through the framework of colleges of supervisors. The revised Capital Requirements Directive provided the legal foundation for the establishment of colleges of supervisors for cross-border banking groups.<sup>126</sup> These are permanent, although flexible, structures for cooperation and coordination among the authorities respon-

<sup>122</sup> The ESRB Regulation, Arts 15(6)–(7).

<sup>123</sup> IMF Country Report (n 121), para. 24.

<sup>124</sup> *Ibid.*

<sup>125</sup> For discussion on the confidentiality agreement between the ESRB and the ESAs, November 2011 see p 10, n 27.

<sup>126</sup> Directive 2009/111/EC of 16 September 2009 amending Directives 2006/48/EC, 2006/49/EC and 2007/64/EC as regards Banks Affiliated to Central Institutions, Certain Own Funds Items, Large Exposures, Supervisory Arrangements, and Crisis Management OJ L302/97 (hereinafter the CRD, known as CRD 2), Art. 131a.

On the operation of colleges of supervisors see also Julia Black, *Restructuring Global and EU Financial Regulation: Capacities, Coordination and Learning* 18 LSE Law Society and Economy Working Papers (2010) <[http://www.lse.ac.uk/collections/law/wps/WPS2010-18\\_Black.pdf](http://www.lse.ac.uk/collections/law/wps/WPS2010-18_Black.pdf)> accessed 10 November 2011; The House of Lords, European Union Committee, *Fourteenth Report of Session 2008–2009 on the Future of EU Regulation and Supervision* HL Paper 106 Volume I paras 196–197 (2009).



sible for and involved in the supervision of the different components of cross-border banking groups.<sup>127</sup> The colleges of supervisors provide a platform for sharing of information, views and assessments amongst supervisors;<sup>128</sup> developing a common understanding of the risk profile of the group at both the group and solo levels and taking due account of macro-prudential risks; developing examination programmes based on the risk assessment of the group; coordinating supervisory reviews and carrying out joint risk assessments; coordinating decisions taken by individual authorities and striving to reach consensus.<sup>129</sup> The mechanism has been praised for its contribution to building trust between supervisors and developing a consistent interpretation and application of regulatory provisions across the group.<sup>130</sup> However, despite the recognised benefits of the colleges it is not always clear that the supervisors' incentives are such as to maximise information sharing. The national authorities may be reluctant to share information with their college colleagues about a distressed financial institution to protect their own jurisdiction. Consequently, there may be scope for information not being brought at all to the attention of the college participants, or not being brought on a timely basis.<sup>131</sup> In particular, softer information with more subjective nature, such as supervisory risk assessments, makes delays and manipulation relatively easy.<sup>132</sup> Safeguarding confidentiality, via a network of bilateral and multi-lateral Memoranda of Understandings, might minimise this problem and maximise coordination and cooperation process within supervisory colleges.<sup>133</sup> However, these

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<sup>127</sup> The Committee of European Banking Supervisors (now replaced by the EBA), *Guidelines for the Operational Functioning of Supervisory Colleges* (15 June 2010) GL 34 <<http://www.eba.europa.eu/documents/Publications/Standards---Guidelines/2010/Colleges/CollegeGuidelines.aspx>> accessed 10 November 2011.

<sup>128</sup> Members of the college are supervisors from a member state where a subsidiary is located or which contains significant branches of the financial institution, central banks as appropriate, and third countries' competent authorities where appropriate (CRD 2, Art. 33).

<sup>129</sup> *Ibid.*, This is not an exhaustive list.

<sup>130</sup> The European Union Committee's *Report on the Future of EU Regulation and Supervision* paras 145–151 (n 117). In the international level see the Basel Committee on Banking Supervision, *Good Practice Principles on Supervisory Colleges* (October 2010) <<http://www.bis.org/publ/bcbs177.pdf>> accessed 16 April 2012, in particular Principle 1 on College Objectives.

<sup>131</sup> The IMF Country Report (n 121), para. 27.

See also the CEBS (now replaced by the EBA) Report of the Peer Review on the Functioning of Supervisory Colleges (18 October 2010) <<http://www.eba.europa.eu/documents/Review-Panel/Peer-Review-Report-on-the-functioning-of-colleges.aspx>> accessed 10 November 2011. For a comprehensive account of the conflict between the home and host supervisors in sharing information see Katia, D'Hulster, *Incentive Conflicts in Supervisory Information Sharing Between Home and Host Supervisors*, World Bank Policy Research Working Paper, No 5871 (November 2011).

<sup>132</sup> Cornelia Holthausen and Thomas Ronde, *Cooperation in International Banking Supervision*, Working Paper No 316, European Central Bank, Frankfurt am Main (March 2004). The MoUs are confidential and therefore the accountability of its parties is limited.

<sup>133</sup> According to the IMF Country Report (n 121), para. 27 there are in some cases legal prohibitions on the sharing of information, so that supervisors from one Member State cannot provide more than generalities about the activities of the bank/insurer they are supervising. In contrast, the *EBA Report of the Peer Review on the Functioning of Supervisory Colleges* (18 October 2010) <<http://www.eba.europa.eu/documents/Review-Panel/Peer-Review-Report-on-the-functioning-of-colleges.aspx>> accessed

non-binding and non-enforceable agreements do not resolve the incentive problem in sharing information between supervisors and therefore cannot guarantee a complete flow of information.<sup>134</sup> To maximise incentives for sharing information, establishment of *ex ante* agreements between supervisors setting out principles for fair “burden sharing” in such a manner that supervisors have an interest in the outcome of the institution as a whole should be considered.<sup>135</sup>

The ESAs were formed with a view to complement this existing system of colleges of supervisors. They are tasked with promoting and mitigating the efficient, effective and consistent functioning of the colleges of supervisors.<sup>136</sup> In order to facilitate the work of the colleges, the ESAs have full participation: they are able to participate in the colleges’ activities, request further deliberations of a college, request to schedule a meeting or add a point to the agenda of the meeting.<sup>137</sup> The active participation in the colleges will enable the ESAs to gather qualitative information to complement the regular and ad hoc data collection as discussed in section 2. Yet, a satisfactory legal framework to accommodate the exchange of data originated in the colleges of supervisors with the ESAs for the purpose of channelling it to the ESRB does not exist. For instance, the ESAs are tasked in Art. 31(f) of the ESAs Regulations with establishing and managing a central European database containing all the relevant micro information gathered from competent authorities through the colleges and regulatory reporting obligations.<sup>138</sup> The ESAs Regulations specify that the competent authorities in the colleges will have access to this database<sup>139</sup> but fail to permit access to the ESRB subject to confidentiality agreements.<sup>140</sup>

A laconic requirement of the colleges of supervisors for banking, insurance and financial conglomerate sectors to cooperate with the authorities can be found in the Colleges of Supervisors – 10 Common Principles.<sup>141</sup> Guidelines set out in 2010 by the Committee of European Banking Supervisors (the CEBS and now replaced by the

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16 April 2012 states briefly in paragraph 79 that no particular problems with confidentiality issues were identified within the colleges.

<sup>134</sup> Andrea Enria and Jukka Vesala (2003) *Externalities in Supervision* in JJM Kremers, D Schoenmaker and PJ Wiers (eds), *Financial Supervision in Europe*, 60–89 (Cheltenham: Edward Elgar).

<sup>135</sup> The *IMF Country Report* (n 121), para. 28. Charles Goodhart and Dirk Schoenmaker, *Fiscal Burden Sharing in Cross-Border Banking Crises* International Journal of Central Banking 141 (2009).

<sup>136</sup> The EBA Regulation, the EIOPA Regulation and the ESMA Regulation, Art. 21, respectively

<sup>137</sup> *Ibid.*

<sup>138</sup> Andrea Enria, *Micro-Data for Micro- and Macro-prudential Purposes* (The Sixth ECB Statistics Conference “Central Bank Statistics as a Servant of Two Separate Mandates: Price Stability and Mitigation of Systemic Risk”, 17–18 April 2012); <[http://www.ecb.int/events/pdf/conferences/stats6th/Session\\_3\\_1\\_Mr\\_Andrea\\_Enria.pdf?818e41ada2fc4f5ec98c06124ef7d742](http://www.ecb.int/events/pdf/conferences/stats6th/Session_3_1_Mr_Andrea_Enria.pdf?818e41ada2fc4f5ec98c06124ef7d742)> accessed 16 April 2012.

<sup>139</sup> The EBA Regulation, the EIOPA Regulation and the ESMA Regulation, Art. 31(f).

<sup>140</sup> But see the Council of the European Union, *Conclusions on Strengthening EU Financial Supervision* (9 June 2009), 10862/09, para. 9(3). In the absence of specific reference, the exchange may fall under the general provision for information exchange with the ESRB, The EBA Regulation, the EIOPA Regulation and the ESMA Regulation, Art. 35, respectively.

<sup>141</sup> The Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), and their Interim Working Committee on Financial Conglomerates (IWCFC), *Colleges of Supervisors – 10 Common Principles* (27 January

EBA) provide a more detailed provision for sharing information obtained in the colleges with the EBA (hereinafter: the 'Colleges Guidelines').<sup>142</sup> In particular, guideline 16 provides that the EBA will be invited to attend the meetings and exposed to all the information of particular relevance for the purposes of supervisory convergence. The Colleges Guidelines should be updated to reflect the new purpose for which these data are needed: disclosure of data to the ESRB for conducting its macro-prudential supervision. Confidentiality of data should be strictly guarded particularly ensuring that specific institutions cannot be identified from the disclosed data. To this end, the rules established and agreed between the ESRB and the ESAs for data aggregation can form the basis for the disclosure to the ESRB.

Another area that should be addressed is the substance of the information exchanged between financial institutions and national supervisors, which will be streaming later on to the ESAs and then to the ESRB. In accordance with Art. 132 of Directive 2006/48/EC, as amended, competent authorities are required to communicate on their own initiative to competent authorities in other Member States with any information that is essential for the exercise of their tasks under this directive.<sup>143</sup> Any relevant information will be communicated on request, taking into account the importance of the institution concerned.<sup>144</sup> A Peer Review conducted by the CEBS in 2010 on the operation of colleges of supervisors revealed a great deal of variety in the information being shared in the colleges.<sup>145</sup> Colleges' members observed that no clear distinction could be drawn between 'essential' information and 'relevant' information, as provided for in Art. 132 of Directive 2006/48/EC.<sup>146</sup> Hence, the Review Panel suggested that putting in place an agreement on a non-exhaustive list of information to be shared within the colleges would assist the ESAs in creating convergence among colleges and consistency of the information.<sup>147</sup>

The cooperation between EU supervisory colleges is only the tip of the iceberg. It is to be remembered that nearly all major EU financial institutions have substantial activity worldwide.<sup>148</sup> At present, these institutions might participate in international

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2009) <<http://www.eba.europa.eu/cebs/media/Publications/Other%20Publications/Supervisory%20Colleges/10-common-principles.pdf>> accessed 10 November 2011.

<sup>142</sup> CEBS' *Guidelines for the Operational Functioning of Supervisory Colleges*.

<sup>143</sup> Relating to the Taking Up and Pursuit of the Business of Credit Institutions OJ L177. Information is essential if it could materially influence the assessment of the financial soundness of a credit institution or financial institution in another Member State (Art. 132(1)).

<sup>144</sup> *Ibid.*

<sup>145</sup> and a number of commonalities, *The 2010 CEBS' Report of the Peer Review on Colleges Functioning* (n 131), para. 68.

<sup>146</sup> See n 143.

<sup>147</sup> *The 2010 CEBS Report of the Peer Review on Colleges Functioning* (n 131), para. 75. Colleges act as vertical groups for enhancing cooperation in one specific institution but there is need also for horizontal convergence, connecting between the colleges, see the *IMF Country Report* (n 105), para. 149.

<sup>148</sup> *The IMF Country Report* (n 111), para. 29; Deutsche Bank Research, *Home Sweet Home? International Banking After the Crisis* EU Monitor 80 (9 June 2011) <[http://www.dbresearch.com/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000274061.PDF](http://www.dbresearch.com/PROD/DBR_INTERNET_EN-PROD/PROD0000000000274061.PDF)> accessed 10 November 2011.

colleges as well.<sup>149</sup> If an international college exist in parallel to a European one there is no systematised process in which the two colleges can exchange information with respect to the same financial institution. Until such framework is formed, cooperation with third countries can be ensured through Memoranda of Understanding (MoU), which would include, for instance, provisions for information sharing on a regular basis, periodic joint inspection exercises and confidentiality safeguards.

Finally, one of the crucial challenges for the ESAs will be to achieve strong convergence in regular supervisory reporting requirements and accordingly, to promote the comparability of financial data across Member States. Progress has already been made in this field led in each sector by the relevant ESA. The EBA mandated COREP as the standardised reporting framework for credit institutions from 31 December 2012.<sup>150</sup> The EIOPA is currently developing harmonised reporting templates to meet requirements under the Solvency II Directive which would enhance the availability of supervisory information on insurance firms.<sup>151</sup> Lastly, the ESMA set up a central depository (CEREP) to collect data on CRAs and is developing standards for reporting requirements.<sup>152</sup>

### *Commercial Data Providers*

Existing commercial data providers, such as Datastream, offer information that can be utilised for macro-prudential analysis.<sup>153</sup> The term ‘commercial data providers’ include trade repositories, credit registers, cheque and securities clearing systems and stock, futures and options exchanges.<sup>154</sup> Each one of these is subject to a different legal framework and provides varied data that can enhance the ESRB information base.

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<sup>149</sup> According to the G-20 Declaration, Strengthening the Financial System—London Summit, (2 Apr. 2009) 28 colleges for significant cross-border firms were in place at the time. The FSB was tasked with establishing the remaining supervisory colleges for significant cross-border firms by June 2009.

<sup>150</sup> In accordance with Art. 74 of Directive 2006/48/EC as amended by Directive 2009/111/EC of 16 September 2009. The EBA is currently working on the development of uniform reporting standards in accordance with Art. 74(2) of Directive 2006/48/EC (as amended by Art. 9(21) of Directive 2010/78/EU of 24 November 2010): The EBA, *Consultation Paper on Draft Implementing Technical Standards on Supervisory Reporting Requirements for Institutions* (CP 50, 20 December 2011).

<sup>151</sup> The EIOPA, *Consultation Paper on the Proposal on Quantitative Reporting Templates* (CP-11/009, 8 November 2011).

<sup>152</sup> The ESMA Consultation Paper, *ESMA's draft Regulatory Technical Standards on the Presentation of the Information that Credit Rating Agencies Shall Disclose in Accordance with Art. 11(2) and point 1 of Part II of Section E of Annex I to Regulation (EC) No 1060/2009* (CP 304, 19 September 2011).

<sup>153</sup> Data from Datastream was analysed in the IMF Global Financial Stability Report, *Grappling with Crisis Legacies* (September 2011) (see Ch. 3: *Toward Operationalizing Macroprudential Policies: When to Act?*).

<sup>154</sup> Gareth Murphy and Robert Westwood, *Data Gaps in the UK Financial Sector: Some Lessons Learned from the Recent Crisis* (The Irving Fisher Conference on Data Gaps, Basel, 25–26 August 2010) <<http://www.bis.org/ifc/events/5ifcconf/murphy.pdf>> accessed 10 November 2011.

While commercial data providers are potentially an essential rich source of information for the ESRB information base, a number of reservations should be made regarding their usefulness for macro-prudential analysis. First, as the data may be privately owned, it may only be accessible at a cost.<sup>155</sup> Secondly, these data may be available only with significant lags and they do not necessarily contain sufficient detail on essential items for macro-prudential analysis.<sup>156</sup> Thirdly, it is unlikely that the ESRB will be able to piece together information from different sources as the available data is not always standardised and therefore such information would lack comparability. Finally, the integrity and security of the data can be put into question.<sup>157</sup>

The following sections concentrate on the operation of trade repositories and credit registers and evaluate the current legal framework for channelling the data stored in these commercial data providers to the ESRB.<sup>158</sup> It will be seen that at present the way the ESRB can access data stored in these sources is cumbersome and fragmented though with regard to trade repositories this may soon change.

### *Trade Repositories*

Trade repositories collect information on trades in over-the-counter (OTC) derivatives i.e. those derivative products that are not traded on exchanges, but instead privately negotiated between two counterparts.<sup>159</sup> The financial crisis highlighted deficiencies within the OTC derivatives markets, in particular lack of transparency and visibility of exposures available to both market participants and supervisors.<sup>160</sup> Moreover, the complex web of relationships in the OTC market meant that default

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<sup>155</sup> But see below that data provided to regulators by the Depository Trust and Clearing Corporation (DTCC) on credit and equity derivatives is free of charge. For more information refer to the Depository Trust and Clearing Corporation (DTCC) <<http://www.dtcc.com>> accessed 16 April 2012.

<sup>156</sup> Stephan Cecchetti, Ingo Fender and Patrick McGuire, *Toward a Global Risk Map* (2010), n74.

<sup>157</sup> For instance, voluntary reporting of hedge funds to commercial data providers may give rise to a self-selection bias (a proportion of good or bad performing hedge funds systemically avoiding reporting). The Centre of Hedge Fund Research, Imperial College, *The Value of the Hedge Fund Industry to Investors, Markets and the Broader Economy* (2012) <<https://www.kpmg.com/KY/en/Documents/the-value-of-the-hedge-fund-industry-part-1.pdf>> accessed 16 April 2012. But see section 5 below on hedge funds reporting in the EU.

<sup>158</sup> Recently the ECB suggested to establish an EU Central Database on Euro Repos to enable monitoring of the segment in the shadow banking, see Vitor Constâncio, *Towards Better Regulation of the Shadow Banking System* (European Commission Conference, Brussels, 27 April 2012) <http://www.ecb.int/press/key/date/2012/html/sp120427.en.html>> accessed 16 April 2012.

<sup>159</sup> House of Lords, European Union Committee, 10th Report of Session 2009–10, *The Future Regulation of Derivatives Markets: Is the EU On the Right Track?* HL Paper 93 (2010) <<http://www.publications.parliament.uk/pa/ld200910/ldselect/ldcom/93/93.pdf>> accessed 10 November 2011; See also *The Regulation of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties (CCPs) and Trade Repositories* COM (2010) 484 (hereinafter the EMIR), Art. 2.

<sup>160</sup> The Commission, *Staff Working Paper Accompanying the Commission Communication Ensuring Efficient, Safe and sound Derivatives Markets*, SEC (2009) 905 final, p 9.

of a major market participant could pose systemic risk to the financial system.<sup>161</sup> The only trade repository that existed when the financial crisis started in 2007 was the Trade Information Warehouse.<sup>162</sup> It proved to be a very useful tool, after Lehman's default, for increasing transparency and reducing uncertainty in the Credit Default Swaps (CDS) market, albeit with a delay.<sup>163</sup> Following this positive experience additional trade repositories were launched to cover other segments of the OTC market.<sup>164</sup> Currently, these trade repositories do not provide complete and comprehensive coverage of the entire OTC derivatives market<sup>165</sup> and in order to gain access to the stored data the ESRB needs to sign MoUs with the national regulators of the trade depositories.<sup>166</sup>

This cumbersome way of accessing data stored in trade repositories may soon change. The Regulation (EU) 648/2012 on OTC Derivatives, Central Counterparties (CCPs) and Trade Repositories, known as the European Market Infrastructure Regulation (hereinafter the EMIR) came into force on 16 August 2012.<sup>167</sup> One of the key changes in the EMIR is the introduction of a mandatory requirement to report certain

<sup>161</sup> Particularly considering the extensive volume of trading in the OTC markets in the EU. In April 2007, the EU accounted for 63% of the interest rates derivatives market and 54% of the foreign exchange derivatives market. In comparison, the US accounts for 24% and 15%, respectively BIS, *Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in 2007 – Statistical Annex Tables 127 and 129* <<http://www.bis.org/publ/rpfx07a.pdf>> accessed 16 April 2012.

<sup>162</sup> The European Commission, *Staff Working Document, Impact Assessment, Accompanying documents to the Proposal for a Regulation of the European Parliament and of the Council on OTC Derivatives, Central Counterparties and Trade Repositories*, para. 3.3.1, SEC (2010) 1058. <[http://ec.europa.eu/internal\\_market/financial-markets/docs/derivatives/20100915\\_impact\\_assessment\\_en.pdf](http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_impact_assessment_en.pdf)> accessed 10 November 2011.

<sup>163</sup> *Ibid.* The Trade Information Warehouse was later renamed into the Warehouse Trust. Currently, it operates an online global regulators' portal that gives global supervisors members of the OTC Derivatives Regulators' Forum (OTCDRF) access to data on credit and equity derivatives. As of November 2011, nearly 40 regulators are using the portal. For more information refer to the DTCC website <<http://www.dtcc.com>> accessed 16 April 2012. The access to the information stored in the Warehouse Trust complies with the Guidance set out by the OTCDRF in June 2010 <[http://www.dtcc.com/downloads/products/derivserv/ODRF\\_guidelines.pdf](http://www.dtcc.com/downloads/products/derivserv/ODRF_guidelines.pdf)> accessed 16 April 2012.

<sup>164</sup> One for interest rate derivatives and one for equity derivatives. TriOptima was selected by the ISDA Operations Steering Committee (OSC) as the provider of the former, while DTCC/Markiserve was chosen to run the latter, *Impact Assessment Accompanying documents to the Proposal for a Regulation on OTC Derivatives, Central Counterparties and Trade Repositories* para. 3.3.1 (n 144). The OSC is a consortium that includes 14 major dealers (the G14) in the OTC derivatives market, a number of buy-side institutions and industry associations. See n 170 on other Trade Repositories in other segments of the OTC markets.

<sup>165</sup> *Impact Assessment Accompanying documents to the Proposal on OTC Derivatives, Central Counterparties and Trade Repositories* para. 3.3.3 (n 162). The Warehouse Trust is the only one that comes close to full coverage of credit derivatives (CDs).

<sup>166</sup> *Ibid.*, para. 6.1.1 For instance – the available data on OTC derivatives is limited to OSC members. In segments, such as interest rates, where the weight of OSC members is significantly lower market coverage would be incomplete.

<sup>167</sup> The EMIR (n 159); In accordance with the communiqué of the G20 Summit at Pittsburgh in September 2009 that "All standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012



details of OTC derivative transactions in the EU to trade repositories.<sup>168</sup> In addition, information on the risks inherent in OTC derivatives markets will be centrally stored and easily accessible to the relevant competent authorities.<sup>169</sup> It is interesting to note here two amendments in the text adopted by the European Parliament on the 5th of July 2011: The first is that the ESRB was added in the list of entities that information stored in trade repositories will be made available to.<sup>170</sup> The second amendment is the requirement that information will be available to these entities (and the ESRB among them) provided that the access to it is strictly necessary to enable them to fulfil their respective responsibilities and mandates.<sup>171</sup> This amendment was in the spirit of the European Data Protection Supervisor (hereinafter ‘the EDPS’) opinion which raised concerns, *inter alia*, with regard to disclosure of personal data to the competent authorities and the failure to specify the purpose for which the information held by trade repositories can be accessed by the competent authorities.<sup>172</sup> The EDPS emphasised in its opinion that even where the parties to the transaction are not natural persons personal data may still be processed, such as the names and contact details of companies’ directors. This requirement was amended in the latest Council Text of the EMIR Proposal but did not find its way to the final text of the EMIR.<sup>173</sup> Indeed, while it is crucial to ensure that the information being exchanged meets the proportionality principle and that the purposes for which it can be processed are defined and limited,<sup>174</sup> the added words “strictly necessary” could have proven to be an obstacle

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at the latest. OTC derivative contracts should be reported to trade repositories. Non-centrally cleared contracts should be subject to higher capital requirements...”

<sup>168</sup> The EMIR (n 159), Art. 9.

<sup>169</sup> The EMIR (n 159), Art. 81.

<sup>170</sup> The European Parliament amending (first reading) the proposal for a regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories’ COD (2010) 0250, Art. 67(2)(aa). This is in accordance with the ECB Opinion, Amendment 45, OJ C/2011/57/1.

<sup>171</sup> *Ibid.* See also Art. 67a of the Parliament amendments to the EMIR Proposal that requires trade repositories to be adequately organised in order to be in a position to give to the ESMA and relevant competent authorities direct and immediate access to the details of derivatives contracts.

<sup>172</sup> The Opinion of the European Data Protection Supervisor (the ‘EDPS’) on the proposal for a Regulation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories [2011] OJ C216/9 <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2011:216:0009:0016:EN:PDF>> accessed 10 November 2011 (hereinafter the EDPS’ opinion), para. 27, requiring to include purpose limitation in the Art. 67. The wording ‘strictly necessary’ is derived from the principle of proportionality which is laid down in Art. 5 of the Treaty on European Union. The criteria for applying it is set out in the Protocol (No 2) on the application of the principles of subsidiarity and proportionality annexed to the Treaties.

<sup>173</sup> The Council, *Proposal for a Regulation on OTC Derivative Transactions, Central Counterparties and Trade Repositories*, 2010/0250 (COD) (4 October 2011).

<sup>174</sup> For examination of the European Court of Justice’s approach to the principle of proportionality in data protection cases under Directive 95/46 of 24 October 1995 on the Protection of Individuals with regard to the Processing of Personal Data and on the Free Movement of such Data OJ L 281 p 31 see Charlotte Bagger Tranberg, *Proportionality and Data Protection in the Case law of the European Court of Justice* 1 International Data Privacy Law 239–248 (2011). But see Jonas Christoffersen, *Fair Balance: Proportionality, Subsidiarity and Primacy in the European Convention on Human Rights*



to the easy flow of information between trade repositories and the relevant authorities, including the ESRB.

In view of the central role of trade repositories in collection of regulatory information, the EMIR confers new powers on the ESMA as the sole authority with the responsibility to register and exercise surveillance of trade repositories in the EU.<sup>175</sup> The ESMA will ensure an unfettered access to all the relevant European authorities, including the ESRB to the data stored in the trade repositories and will act as the European contact point to deal with competent authorities of third countries trade repositories.<sup>176</sup> Additionally, addressing the need for the information to be comparable across EU trade repositories, the ESMA will be responsible for development of regulatory technical standards specifying the details of the information to be disclosed.<sup>177</sup>

The OTC market, by its very nature, is global and therefore it is crucial to ensure that there are no legal obstacles in place that would prevent an effective mutual exchange of information and that there is an unfettered access to data maintained in a trade repository located in a third country.<sup>178</sup> Addressing the need for supervisory and regulatory convergence, the EMIR stipulates that where a trade repository is established in a third country, there is a need to conclude an international agreement for the trade repository to be recognised by the ESMA.<sup>179</sup> Moreover, the EMIR recognises the importance of ensuring international convergence of requirements for trade repositories reporting.<sup>180</sup> Unfortunately, U.S. and EU supervisors are facing difficulties in finding common ground, despite their recognition of the importance of international

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(Martinus Nijhoff Publishers, 2009) on the general rejection of the European Court of Human rights the principle of strict necessity. In particular, the author points out that necessity is not as flexible as other terms, such as reasonable

<sup>175</sup> The EMIR (n 159), Arts 55, 71 and 73.

<sup>176</sup> The EMIR (n 159), Art. 75–77 and 84. The EDPS has also raised concerns regarding the vast powers entrusted with the ESMA (n 172). See also the FSA and HM Treasury, *Reforming OTC Derivatives Markets, A UK Perspective* (December 2009) <[http://www.fsa.gov.uk/pubs/other/reform\\_otc\\_derivatives.pdf](http://www.fsa.gov.uk/pubs/other/reform_otc_derivatives.pdf)> accessed 10 November 2011.

<sup>177</sup> The EMIR (n 149), Art. 81. The Parliament amended this Article to include operational standards that are required in order to aggregate and compare data across trade repositories and when necessary for the authorities to have access to that information (n 151). This amendment did not appear in the Council text.

<sup>178</sup> Sally Davies, *Cross-border Derivatives Exposures: How Global are Derivatives Markets?* (July 2009) <<http://www.bis.org/ifc/publ/ifcb31n.pdf>> accessed 16 April 2012.

<sup>179</sup> The EMIR (n 149), Arts 75–76. As well as the requirement to be recognised by the Commission, as having an equivalent and enforceable regulatory and supervisory framework and has established co-operation arrangements with the Union pursuant to Art. 62(3) to ensure that Union authorities, including ESMA, have immediate and continuous access to all the necessary information.

<sup>180</sup> The EMIR (n 159), Preamble 90. To promote the international convergence in this area the DTCC was selected by ISDA (International Swaps and Derivatives Association), the AFME (Association for Financial Markets in Europe) and the Asia Securities Industry & Financial Markets Association to be the service provider of global trade repositories for Interest Rates, Commodities and Foreign Exchange derivatives, adding to its already existing repositories for Credit and Equity derivatives, for more detail see the DTCC website <[http://www.dtcc.com/products/derivserv/suite/global\\_trade\\_repository\\_for\\_otc\\_derivs.php](http://www.dtcc.com/products/derivserv/suite/global_trade_repository_for_otc_derivs.php)> accessed 16 April 2012.

cooperation in a global market, such as the OTC derivatives one. The source of the disagreement is section 763(i) of the Dodd-Frank Act that requires any U.S. or foreign authority, other than the SEC, seeking to obtain data from a security-based swap data repository to agree to provide indemnification to the security-based swap data repository and the SEC “for any expenses arising from litigation relating to the information provided”.<sup>181</sup> The ESMA expressed its concerns with regard to this indemnification requirement and strongly stated that it undermines the key principle of trust according to which exchange of information should occur between the authorities. These regulatory barriers based on the location of trade repositories can result in the establishment of separate local trade repositories in various jurisdictions. A multiple system of trade repositories is clearly inefficient as it forces supervisors to interact with different trade repositories and may result in fragmentation of the data available to supervisors.<sup>182</sup> Consequently, the SEC has recommended recently the Congress to remove the indemnification requirement while ensuring confidentiality is preserved.<sup>183</sup>

The proposed regional legislation in this area should be viewed in the context of other international initiatives, such as the creation of the OTC Derivatives Regulators’ Forum (the ‘OTCDRF’) in September 2009.<sup>184</sup> The forum comprised of international financial regulators, with the aim of coordinating and articulating information needs of the regulatory community in OTC derivatives markets and designing and implementing common reporting expectations from CCPs and trade repositories.

### *Credit Registers*

At present credit registers exist in all EU Member States, either in the form of public registers (there are 14 in the EU) or private credit bureaus (22 of them).<sup>185</sup> Public credit registers are typically run by central banks or supervisory authorities.

<sup>181</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act (Public Law No 111–203 enacted on July 21, 2010).

<sup>182</sup> The ESMA, *Rulemakings on Registration of Non-resident Swap Data Repositories* (17 January 2011) <<http://www.sec.gov/comments/s7-35-10/s73510-19.pdf>> accessed 16 April 2012.

<sup>183</sup> Ethiopis Tafara Director in the Office of International Affairs U.S. Securities and Exchange Commission, *Testimony Concerning Indemnification of Security-Based Swap Data Repositories before the Subcommittee on Capital Markets and Government Sponsored Enterprises*, United States House of Representatives on 21 March 2012 <<http://www.sec.gov/news/testimony/2012/ts032112et.htm>> accessed 16 April 2012.

<sup>184</sup> More information on this forum can be found at <http://otcdrf.org>, in particular see the *Framework for Information Sharing and Cooperation among OTC Derivatives Regulators* (22 September 2009) <[http://www.otcdrf.org/documents/framework\\_sept2009.pdf](http://www.otcdrf.org/documents/framework_sept2009.pdf)> accessed 10 November 2011. For further information on the global convergence of OTC Reporting see the FSB Report, *Implementing OTC Derivatives Market Reforms* (25 October, 2010) <[http://www.financialstabilityboard.org/publications/r\\_101025.pdf](http://www.financialstabilityboard.org/publications/r_101025.pdf)> accessed 16 April 2012; CPSS-IOSCO – *Consultative Report on Data Reporting and Aggregation Requirements* (August 2011) <<http://www.bis.org/publ/cpss96.pdf>> accessed 16 April 2012.

<sup>185</sup> ECB, *Memorandum of Understanding on the Exchange of Information Among National Central Credit Registers for the Purpose of Passing it on to Reporting Institutions* (Frankfurt, April 2010) <<http://www.ecb.int/pub/pdf/other/memoxinccreditregisters201004en.pdf>> accessed 10 November 2011.

Reporting to public credit registers is a legal obligation and they operate on a non-profit basis. Private credit registers, on the other hand, have varied membership structures and are mainly for-profit.<sup>186</sup>

The objectives of the credit registers typically include providing information for lenders' due diligence, banking statistics and financial stability.<sup>187</sup> There is a correlation between the most dominant objective amongst these and the reporting threshold: the higher the threshold is, the more dominant the financial stability objective will be. As might be expected, EU Member States differ widely in the data collected by credit registers and their threshold of the mandatory disclosure in their public credit registers. For instance, in Portugal the reporting threshold is very low (€50) as opposed to Germany (€1.5 million) and accordingly the ability to utilise the information gathered for macro-prudential analysis differs.<sup>188</sup>

A Memorandum of Understanding (MoU) for regular exchange of information between several central banks in the EU with respect to large corporate borrowers (at least €25,000) was initially set up in 2003 and amended in 2010.<sup>189</sup> As its name suggests, however, the main purpose of the MoU is to allow reporting institutions to obtain a more complete overview of the indebtedness of a borrower. The preamble indeed states that public credit registers provide useful additional information to supervisory authorities on credit concentration but no further reference is made for exchange of information with the respective supervisory authorities of the parties. Furthermore, it seems that the operation of the MoU is somewhat disappointing and that the exchange of information is limited and cumbersome.<sup>190</sup>

The Issing Committee, mandated by the G-20 to provide recommendations for a new financial order, recommended in its 2009 report establishing a supra-national credit register that will bring a standardisation across countries and will allow supervisors to improve their financial stability role.<sup>191</sup> Ironically, at the same year, the Experts Group on Credit Histories mandated by the European Commission rejected the idea of creating a single pan-European retail credit register, at least for the foreseeable future, for being time consuming and costly.<sup>192</sup> The Expert Group briefly noted that the situation could be appreciated differently when dealing with corporate credit.<sup>193</sup> Weighing the benefits of data maintained in credit registers on corporate credit as one of the tools of supervisors for global monitoring of systemic risks against the costs of establishing such an entity the balance may indeed support the view of the Issing Committee.

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<sup>186</sup> *Report of the Expert Group on Credit Histories* mandated by COM (2008) 543 (15 May 2009) <[http://ec.europa.eu/internal\\_market/consultations/docs/2009/credit\\_histories/egch\\_report\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2009/credit_histories/egch_report_en.pdf)> accessed 10 November 2011, para. 3.1.

<sup>187</sup> The Issing Recommendations (n 78), para. 3.1

<sup>188</sup> *Ibid.*, para. 3.2.

<sup>189</sup> The MoU on the Exchange of Information (n 185), para. 3.

<sup>190</sup> The Issing Recommendations (n 78), para. 3.2.

<sup>191</sup> *Ibid.*, para. 3.5.

<sup>192</sup> The Report of the Expert Group (n 186), para. 4.1.5

<sup>193</sup> *Ibid.*, fn 28 on p 25.

In the absence of a single credit register in the EU and an efficient framework for exchange of information amongst credit registers for supervisory purposes, there is a need to set up a framework for cooperation between the ESRB and EU national central banks and their respective public credit registers and, where necessary, with private credit bureaus. The information gathered via these channels can provide the ESRB with a valuable input in the assessment of systemic importance of financial institutions and the surveillance of shadow banking.<sup>194</sup> Ultimately, harmonisation of the rules concerning credit registers is needed to provide comparable platform of data collection for macro and micro-prudential supervision.

Finally, EU Member States should endeavour to implement the General Principles for Credit Reporting published by the World Bank in March 2011 in their jurisdictions and in particular, principle 5 that deals with cross' border data flow.<sup>195</sup> Principle 5 emphasises the importance of standardisation of information and cooperation and coordination between the relevant regulators initially through periodic meetings (e.g. annual or semi-annual) and later on through MoUs.

### *Market Intelligence*

Thus far this Article has looked critically at the exchange of information process between the ESRB and various defined data sources: European central banks, international institutions, the ESAs and other commercial data providers. These organisational sources, though comprehensive when combined, are still insufficient in providing a full and accurate picture of emerging risks in the EU. They lack the fluidity that is required to maintain a data collection process which is forward-looking and evolving.<sup>196</sup> They are constrained with legal obstacles, national interests and institutional cooperation. Moreover, these sources produce quantitative data and it has been acknowledged that given the nature of financial crises the statistical ability to predict them is limited.<sup>197</sup> Hence, continuous dialogue with a wide spectrum of market participants is a requisite for macro-prudential surveillance and will allow the ESRB to keep track of financial innovations and to maintain the non-regulated or lightly regulated areas under its radar.<sup>198</sup>

<sup>194</sup> Both of these areas will be further explored below in section 5. See, for instance, Matias Gutiérrez Girault and Jane Hwang, *Public Credit Registers as a Tool for Bank Regulation and Supervision*, The World Bank Policy Research Working Paper 5489 (2010).

<sup>195</sup> The World Bank Task Force, *General Principles for Credit Reporting, Consultative Report* (March 2011) <<http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTFINANCIALSECTOR/0,,contentMDK:22912648~pagePK:148956~piPK:216618~theSitePK:282885,00.html>> accessed 10 November 2011.

<sup>196</sup> Yet, it still involves an historic overlook, indicating the build up of risks over time. For the time dimension of systemic risks see n 37 above.

<sup>197</sup> IMF, *Macroprudential Policy: an Organising Framework* (14 March 2011) <<http://www.imf.org/external/np/pp/eng/2011/031411.pdf>> accessed 10 November 2011.

<sup>198</sup> See for instance the Bank of England, *Instruments of Macroprudential Policy, a Discussion Paper* (December 2011) <<http://www.bankofengland.co.uk/publications/Documents/other/financial-stability/discussionpaper111220.pdf>> accessed 10 November 2011 indicating that market intelligence

The ESRB will operate its own market intelligence research through private stakeholders. These include financial sector representatives, consumers associations and users groups in the financial services area established by the commission or by Union legislation.<sup>199</sup> Collection of data in this area is usually done through surveys and industry round tables and it is to be assumed that the ESRB will pay the participating private stakeholders for their services. Bearing in mind that the ECB already has a long history with private stakeholders, its involvement in developing market intelligence networks with the ESRB is essential. The ESRB market intelligence can be complemented by information gathered through the ECB market intelligence, which is already being utilised for the ECB Financial Stability Review.<sup>200</sup>

Given the wide nature of systemic risk market intelligence in this context should not be narrowly interpreted to include only private stakeholders from the financial industry. The ESRB needs to develop an interdisciplinary collaboration with stakeholders outside the financial circles in order to identify and evaluate the impact of other policy areas on the build-up of systemic risks in the financial markets. For instance, a letter that was addressed recently to the ESRB highlighted the systemic risk that the EU's exposure to high carbon investments might pose to the financial system.<sup>201</sup> The signatories of the letter included academics, politicians and other non-profit organisations, such as Greenpeace UK. They stressed that with the transition to a low carbon economy, deploying significant amounts of capital by banks<sup>202</sup> into high carbon sectors or in companies with significant exposure to them can pose systemic risk to the financial system. It was contended that at present the exposure to high carbon investments in the financial markets, particularly in bank loan books, is not fully appreciated and monitored and there is no view on what level would be too high.<sup>203</sup> The Bank of England's Financial Policy Committee agreed that there is scope for further evaluation of this issue and put it on its agenda for discussion<sup>204</sup>.

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recently pointed towards the rapid growth and evolution of the exchange-traded funds industry and well before the crisis, it highlighted the risks involved in collateralised debt obligations.

<sup>199</sup> The ESRB Regulation, Art. 14 and para. 29 in the Preamble.

<sup>200</sup> Eg ECB, *The Financial Stability Review* (June 2011) <<http://www.ecb.int/pub/pdf/other/financialstabilityreview201106en.pdf>> accessed November 2011.

<sup>201</sup> A letter addressed to the Mario Adraghi, Chair of the ESRB, February 2012 <<http://www.capitalinstitute.org/sites/capitalinstitute.org/files/docs/Letter%20to%20European%20Systemic%20Risk%20Board%20-%202002.2012.pdf>> accessed 16 April 2012. See also Ben Caldecott, 'Why High Carbon Investment could be the Next Sub-prime Crisis' (The Guardian, 12 July 2011) <<http://www.guardian.co.uk/environment/2011/jul/12/high-carbon-investment>> accessed 16 April 2012; This letter followed a similar letter addressed to the Bank of England Governor, Sir Mervyn King in January 2012 <<http://www.climatechangecapital.com/media/256968/letter%20to%20bank%20of%20england%20financial%20policy%20committee%20-%202019th%20january%202012%20-%20final.pdf>> accessed 16 April 2012.

<sup>202</sup> As well as institutional investors, companies, mutual funds and retail investors.

<sup>203</sup> A letter to the ESRB on high carbon investment exposures (n 201).

<sup>204</sup> Bank of England, the Financial Policy Committee, a letter addressed to James Cameron, dated 1 February 2012 <<http://www.climatechangecapital.com/media/257552/fpc%20bank%20of%20england%20response.pdf>> accessed 16 April 2012.

Finally, a cautionary note should be made regarding the quality of data gathered through market intelligence. The reliability and accuracy of the information can be put into question as private stakeholders are not necessarily regulated and their views are in their nature subjective and may be motivated by self interest. Clearly though the need to keep the finger on the pulse and be informed of both financial innovations and other policy areas that may affect the financial markets outweigh these problems.

*The ESRB as a Central Hub: Collecting Data from a Wide 'Information Base'*

The ESRB is facing a very intimidating task of collecting slices of data from different sources and creating a unified and clear puzzle of the financial system in the EU and its emerging risks. It is not a one-off exercise but rather a continuous and evolving one, adjusted from time to time to fit the fast changing market demands.

The ESRB operates in this environment as a central hub, ensuring smooth flow of information from central banks, the ESAs and the Member States supervisory authorities. Its information base includes other data sources ranging from commercial data providers, market participants and most importantly, international institutions.

Much of the ESRB success relies on the openness of each one of these channels: the smooth flow of data from financial institutions to national supervisors and central banks, from national supervisors to the ESAs and from the ESAs to the ESRB. The operation of the European colleges of supervisors and the willingness of its members to cooperate will play a major role in this flow.

Assuming the frameworks are operating efficiently and any identified obstacles to the smooth flow of information are removed, as suggested in this section, the ESRB will have an unfettered access to micro-prudential data through the ESAs and macro-prudential data through the ECB. Overall, its information base is comprehensive enough to view the inter-linkages in the financial system within the EU and granular enough to enable it to take action before systemic risks emerge or at least mitigate them soon after their emergence.

## **5. Collecting Information on Shadow Banking and Systematically Important Financial Institutions**

As part of its evolving data collection exercise, the ESRB is currently focusing on two pressing areas: collecting information from the so-called shadow banking and prioritising collection of information from Systematically Important Financial Institutions. These will be examined in more detail in this section.

*Is Shadow Banking Still in the Shadow?*

The term “shadow banking system” began to be used widely at the onset of the 2007–2008 financial crisis referring to entities and activities structured outside the



regular banking system that perform bank-like functions.<sup>205</sup> These institutions, vehicles, instruments and markets are largely engaged in replicating the core activity of traditional banking, credit and maturity transformation.<sup>206</sup> In the midst of the financial crisis it became clear that the shadow banking system can become a source of systemic risk, both directly and indirectly through its interconnectedness with the regular banking system.<sup>207</sup> This threat was exacerbated by the fact that some components of the system remained outside the radar of the supervisory authorities and often excluded from their data collection frameworks. It also entailed the danger of creating opportunities for arbitrage that might undermine stricter bank regulation and lead to a build-up of additional risks in the system.<sup>208</sup> This, however, is changing very rapidly as international institutions, in particular the FSB and the BIS, are focusing their efforts on identifying information gaps and exploring possible regulatory measures to address systemic risks and regulatory arbitrage concerns posed by the shadow banking system.<sup>209</sup> As yet there is no clear commonly-agreed definition of the system. Given its fluid and evolving nature, casting the net wide is a prerequisite for such a definition in order to identify and capture any adaptations or mutations that may be of potential concern for the financial system.<sup>210</sup> Major actors in the shadow banking system include structured investment vehicles, hedge funds and money-market funds.<sup>211</sup> Hedge funds and Money market funds will be the centre of our discussion. Their selection is based on the fact that there is a piece of legislation regulating their operation and is not necessarily correlated to the potential systemic risks they pose on the financial system, as this may change at any given time.<sup>212</sup>

<sup>205</sup> The FSB, *Shadow Banking: Scoping the Issues, a Background Note* (12 April 2011) <[http://www.financialstabilityboard.org/publications/r\\_110412a.pdf](http://www.financialstabilityboard.org/publications/r_110412a.pdf)> accessed 10 November 2011. The exact definition in this background note is “intermediation involving entities and activities outside the regular banking system” at p 1.

<sup>206</sup> Vitor Constâncio (n 91). According to the FSB Background Note on Shadow Banking (n 195) “Maturity transformation” is the activity of issuing short term liabilities (such as deposits) and transforming them into medium–long term assets (such as loans). It is to be noted that according to the background note the core activity could include “Liquidity transformation”, ie the issuing of liquid liabilities to finance illiquid assets. An asset is illiquid when it cannot be easily converted into cash without a loss in nominal value. The FSB estimated the size of the global shadow banking system at around € 46 trillion in 2010 (having grown from € 21 trillion in 2002). This represents between 25% and 30% of the total financial system and half the size of bank assets. FSB, *Strengthening Oversight and Regulation, Recommendations of the FSB* (27 October 2011) <[http://www.financialstabilityboard.org/publications/r\\_111027a.pdf](http://www.financialstabilityboard.org/publications/r_111027a.pdf)> accessed 16 April 2012.

<sup>207</sup> The FSB *Background Note on Shadow Banking* at ‘Introduction’ (n 205). European Commission, *Green Paper, Shadow Banking* (Brussels, 19 March 2012) COM(2012) 102 final.

<sup>208</sup> *Ibid.*, at ‘Introduction’.

<sup>209</sup> Eg Nicholas Vause, *Enhanced BIS Statistics on Credit Risk Transfer*, The BIS Quarterly Review (December 2011), <[http://www.bis.org/publ/qtrpdf/r\\_qt1112i.pdf](http://www.bis.org/publ/qtrpdf/r_qt1112i.pdf)> accessed 10 November 2011 reports that recent BIS credit derivatives statistics suggested that reporting dealers have used some hard-to-value credit derivatives to transfer credit risk to shadow banks.

<sup>210</sup> The FSB *Background Note on Shadow Banking* (n 205), para. 1.

<sup>211</sup> Vitor Constâncio (n 91).

<sup>212</sup> For the potential systemic risk of hedge funds see Andrew W Lo, *The Feasibility of Systemic*



The Alternative Investment Fund Managers Directive (AIFMD), which entered into force on 21 July 2011, brought hedge funds and other investment funds under the spotlight.<sup>213</sup> The mechanism for exchange of information relating to the potential systemic consequences of AIFM activity is found in Art. 53 of the AIFMD. Article 53(1) provides that the competent authorities responsible for the authorisation and/or supervision of AIFMs will communicate to the ESRB information that is relevant for monitoring and responding to the potential implications of the AIFMs for the stability of systemically relevant financial institutions and the orderly functioning of markets on which AIFMs are active.<sup>214</sup> Article 53(2) places an obligation on the competent authorities of the AIFMs to communicate to the ESRB aggregated information relating to the activities of the AIFMs under their responsibilities.<sup>215</sup> Articles 53(3) and 53(4) specify the methods for adoption of measures specifying the content, modalities and frequency of the information to be exchanged. In addition, Art. 25 of the AIFMD requires competent authorities to share information on the levels of leverage in AIFs managed by AIFMs with the ESRB.<sup>216</sup> Thus the AIFMD equips national supervisors and the ESRB with the information necessary to monitor and respond to risks to the stability of the financial system that could be caused or amplified by AIFs' activity.

Money market funds (MMFs), as opposed to hedge funds, do not engage in maturity transformation, however they are inherently fragile and can pose a potential threat for the functioning of the financial system as well.<sup>217</sup> MMFs are regulated under a

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*Risk Measurement: Written Testimony for the House Financial Services Committee Hearing on Systemic Risk Regulation* (19 October 2009) < <http://ssrn.com/abstract=1497682> > accessed 10 November 2011; For a different view see Andrew Baker, 'Hedge Funds are not Shadow Banks' (FT.com, 15 May 2011) <<http://www.ft.com/cms/s/0/611b8e26-7d8d-11e0-b418-00144feabdc0.html#axzz1iZjp3LJN>> accessed 10 November 2011.

<sup>213</sup> Council Directive 2011/61/EU of 8 June 2011 on Alternative Investment Fund Managers amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] OJ L174/1 (hereinafter the AIFMD). EU Member States are required to transpose the AIFMD by 22 July 2013. For the definition of Alternative Investment Funds (AIFs) and Alternative Investment Funds Managers (AIFMs) see AIFMD, Art. 4. AIFMs include not only managers of hedge funds but also, among others, private equity funds, commodity funds, real estate funds and infrastructure funds. See the *Proposal for a Directive on alternative Investment Fund Managers* COM(2009) 207 final, para. 1.1. To portray an accurate picture of the regulatory environment it is crucial to point out that hedge funds have been under the UK regulators' inspected eye long before the beginning of the financial crisis, see for instance Dan Awrey, *The Limits of EU Hedge Fund Regulation* Law and Financial Market Review (2011); Oxford Legal Studies Research Paper No. 8/2011 at <<http://ssrn.com/abstract=1757719>> accessed 10 November 2011.

<sup>214</sup> And ESMA and the competent authorities or other member states.

<sup>215</sup> Subject to Art. 35 of the ESMA Regulation.

<sup>216</sup> And the ESMA and other authorities

<sup>217</sup> Christian Weistroffer, *Identifying Systematically Important Financial Institutions* (Deutsche Bank Research, Frankfurt am Main, August 2011) <[http://www.dbresearch.de/PROD/DBR\\_INTERNET\\_EN-PROD/PROD0000000000276722.pdf](http://www.dbresearch.de/PROD/DBR_INTERNET_EN-PROD/PROD0000000000276722.pdf)> accessed 10 November 2011. Sometimes the term "breaks the buck" is used to describe a situation where the value of securities held in MMF falls below par. In 16th of September, 2008 one of the oldest and largest money market funds in the U.S. – the Reserve Primary Fund – broke the buck. It was the only MMF that broke the buck during the 2008 financial crisis – see

different European piece of legislation, the Undertakings for Collective Investment in Transferable Securities Directive (the UCITS Directive).<sup>218</sup> As opposed to the AIFMD, the UCITS Directive aims solely at investors' protection and promoting transparency to the public and does not provide the ESRB with any specific tools to covering MMFs under its data collection umbrella.

Bringing the shadow banking system into the perimeter of financial regulation in the same manner done in the AIFMD will assist the ESRB in establishing a stream of timely and comparable information. However, markets have a clear tendency to continuously shift their activities outside the regulatory realm. The introduction of more stringent capital requirements in the EU may exacerbate this tendency. The ESRB cannot rely on the legislator's efforts in ensuring the shadow banking system is regulated. Its supervision has to be independent from these efforts, though welcomed. Indeed, the ESRB objectives and tasks are worded widely to encompass shadow banking and other financial institutions<sup>219</sup> and allow it to meet this challenge. The ESRB needs to constantly adapt its data collection exercise in order to reflect the fluidity of the financial markets operation. Market intelligence built on regular dialogue with market participants will play a key role in this chase.<sup>220</sup> Information collected through market intelligence will be useful in providing the ESRB with a forward-looking perspective so that it can anticipate developments and identify emerging risks in the early stages of their inception.<sup>221</sup> The ESRB's work in this area should aim to develop a better understanding of the interconnections between entities within the shadow banking system and regulated banks as well as identifying entities or activities within this system that may be sources of systemic risk.

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Diya Gullapalli and others, 'Money Fund, Hurt by Debt Tied to Lehman, Breaks the Buck', Wall Street Journal, 17 September 2008. The ESRB has recently issued recommendation on MMFs highlighting their potential to spread, or even amplify, a crisis due to their susceptibility to investor runs. It recommended the Commission to ensure that the relevant Union legislation enhances regular harmonised reporting obligations by MMFs and promotes the organisation of information sharing between national supervisory authorities and, inter alia, the ESRB. See Recommendation of the European Systemic Risk Board of 20 December 2012 on money market funds (ESRB/2012/1).

<sup>218</sup> Council Directive 2009/65/EC of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions relating to Undertakings for Collective Investment in Transferable Securities [2011] OJ L302/32 (hereinafter "the UCITS"); On July 2011 the *Guidelines on a Common Definition of European MMFs* that were issued in May 2010 by the Committee of European Securities Regulators (the predecessor of the ESMA) CESR/10-049 came into force (hereinafter "the MMFs Guidelines"); In August 2011 the ESMA released a Q&A document that provides guidance on the MMFs Guidelines

<sup>219</sup> Article 2(b) of the ESRB Regulation defines widely "financial system" to include not only all financial institutions (see definition in Art. 2(a)) but also all markets, products and market infrastructures. See also Bart PM Joosen, *The Limitations of Regulating Macro-prudential Supervision in Europe* 25 J.I.B.L.R. 493–501 (2010).

<sup>220</sup> For an example of the use of market intelligence to identify risks in the shadow banking system see James O'Connor, James Wackett and Robert Zammit, *The Use of Foreign Exchange Markets by Non-Banks* 51(2) Bank of England Quarterly Bulletin 119 (2011) <<http://www.bankofengland.co.uk/publications/quArterlybulletin/qb110204.pdf>> accessed 10 November 2011.

<sup>221</sup> The *FSB Background Note on Shadow Banking* (n 205), para. 2.1.

*Systematically Important Financial Institutions*

Another pressing issue on the ESRB's agenda is the monitoring of Systematically Important Financial Institutions (SIFIs). The first hurdle is to identify these institutions and here the ESRB can follow the guidance provided by the IMF, the BIS and FSB and the criteria put forward recently for consultation by the Basel Committee on Banking Supervision (BCBS) on Global Systematically Important Banks (G-SIB).<sup>222</sup> The key factors according to which systemic importance of markets and institutions should be identified are size (the volume of financial services provided by it), substitutability (the extent to which other components of the system can provide the same services in the event of failure) and interconnectedness (linkages with other components of the system).<sup>223</sup>

Three observations can be made regarding data collection on SIFIs that requires careful consideration. The first is that the ECB has the right to collect statistical information from the 'reference reporting population' as defined in the Council Regulation (EC) No 2533/98 and of what is necessary to carry out the tasks of the ESCB<sup>224</sup>. Article 3 of Regulation (EC) No 2533/98 requires the ECB to specify the 'actual reporting population' within the limits of the reference reporting population. The actual reporting population cover, *inter alia*, all credit institutions resident in the euro area, including branches and subsidiaries whose headquarters are located outside the euro area.<sup>225</sup> Conversely, data of branches or subsidiaries of euro area established

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<sup>222</sup> IMF, BIS and FSB, *Report to G-20 Finance Ministers and Governors-Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations* (28 October 2009) <[www.financialstabilityboard.org/publications/r\\_091107c.pdf](http://www.financialstabilityboard.org/publications/r_091107c.pdf)> accessed 10 November 2011; FSB, *Recommendations and Timelines, Reducing Moral Hazard Posed by Systemically Important Financial Institutions* (20 October 2010) <[http://www.financialstabilityboard.org/publications/r\\_101111a.pdf](http://www.financialstabilityboard.org/publications/r_101111a.pdf)> accessed 10 November 2011; The Basel Committee on Banking Supervision (BCBS), *A Consultative Document: Global Systemically Important Banks: Assessment Methodology and the Additional Loss Absorbency Requirement* (BIS, July 2011) <<http://www.bis.org/publ/bcbs201.pdf>> accessed 10 November 2011.

<sup>223</sup> The ESRB Regulation, Preamble, s 9. The preamble emphasises that an assessment based on these key criteria should be complemented by reference to other considerations and factors, such as, *inter alia*, complexity and intensity and scope of supervision. For G-SIBs criteria the BCBS adds complexity and cross jurisdictional (the BCBS G-SIBs Assessment Methodology, n 212). It is to be noted that this is the only reference to SIFIs that can be found in the ESRB Regulation. The ESRB is not specifically assigned the power to designate institutions as systematically important and it is not listed in its tasks in Art. 3 of the ESRB Regulation. In addition, there is no definition of systematically important and systemic importance in the ESRB Regulation (see for instance the Dodd-Frank Act, Art. 803(9)).

<sup>224</sup> Article 2 of the Council Regulation (EC) No 2533/98 Concerning the Collection of Statistical Information by the European Central Bank, OJ L318/8. as last amended by the Council Regulation (EC) 951/2009.

<sup>225</sup> Regulation of the ECB (EC) No 2423/2001 of 22 November 2001 concerning the Consolidated Balance Sheet of the Monetary Financial Institution Sector (ECB/2001/13) OJ L 333/1. Credit institutions" are defined as any institution falling under the definition contained in the 2000/12 Directive (EC) of 20 March 2000, as amended "(a) an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or (b) an electronic money institution within the meaning of Directive 2000/46/EC of the European Parliament and of the Council

outside the jurisdiction of EU Member States are excluded. Accordingly, the remits of the ESRB data collection is restricted. In practical terms it means that the ESRB does not have access through the ECB to data on SIFIs established outside the EU even though they may have significant activity within the euro area. Relevant data on these institutions will therefore need to be collected from other data sources which may entail setting up the necessary legal arrangements.

The second is that international dimension of the activity of these institutions<sup>226</sup> suggests that the collection of information on the SIFIs by the ESRB will need to be conducted in synergy with other international institutions and through smooth cooperation with supervisory colleges outside the EU, as discussed in section 4.

The last observation concerns the disclosure of the fact that an institution is considered a SIFI. Here the ECB and the ESRB are found between the devil and the deep blue sea. On the one hand, there is a need to collect more granular statistics in order to analyse SIFIs and their interlinkages. On the other hand, disclosing which institution is a SIFI and subjecting it to targeted reporting obligations may lead to increased moral hazard and would leave room for regulatory arbitrage.<sup>227</sup> The solution to this dilemma was presented recently in a form of a 3 tier system.<sup>228</sup> Tier 1 will include all the banking and insurance groups, which are subject to reporting obligations to the ECB.<sup>229</sup> Tier 2 will consist of large banking and insurance groups, defined according to a simple asset threshold value that will be publicly available for reporting purposes.<sup>230</sup> Tier 3 will comprise SIFIs, identified internally according to the G-20 terminol-

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of 18 September 2000 on the taking up, pursuit and prudential supervision of the business of electronic money institutions”.

<sup>226</sup> Stijn Claessens and others, *A Safer World Financial System: Improving the Resolution of Systemic Institutions* (12th Geneva Report on the World Economy, CEPR, London, 2010); <<http://personal.vu.nl/d.schoenmaker/Geneva12.pdf>> accessed on 10 November 2011 observed that on average, the thirty largest SIFIs have 53% of their assets abroad and have close to 1000 subsidiaries, of which 68% operate abroad. Frenklin Allen and others, *Cross Border Banking in Europe: Implications for Financial Stability and Macroeconomic Policies* (Centre for Economic Policy Research, London, 2011) <[http://www.voxeu.org/sites/default/files/file/cross-border\\_banking.pdf](http://www.voxeu.org/sites/default/files/file/cross-border_banking.pdf)> accessed 10 November 2011 further observed that the European banks on this list were far more internationalised than the North American or Asian institutions.

<sup>227</sup> Moral hazard is the expectation that due to its importance the institution will be bailed out or assisted when facing financial difficulty (‘too big to fail’ or ‘too important to fail’). On moral hazard posed by SIFIs see FSB, *Reducing the Moral Hazard by Systematically Important Financial Institutions-Interim Report to G-20 Leaders* (18 June 2010) <[http://www.financialstabilityboard.org/publications/r\\_100627b.pdf](http://www.financialstabilityboard.org/publications/r_100627b.pdf)> accessed 10 November 2011. Identifying institutions as SIFIs may result in downsizing and shedding of certain activities. It could potentially mean the fragmentation of activities and their transfer to smaller participants. Many smaller-sized financial institutions with similar risk profiles can render them ‘systemic in a herd’ and can result in a systemic crisis all the same. See PricewaterhouseCoopers, *Basel 3 and Beyond: Systematically Important Financial Institutions* (November 2011).

<sup>228</sup> Agresti Anna Maria and others, *Enhancement to ECB statistics for Financial Stability Analysis* Irving Fisher Committee Bulletin No 34 (November 2011) <<http://www.bis.org/ifc/publ/ifcb34.pdf>> accessed 16 April 2012.

<sup>229</sup> See the first observation above.

<sup>230</sup> Around 100 large banking groups and 50 large insurance groups, Agresti Anna Maria (n 217), p 23.

ogy discussed above and will not be publicly available.<sup>231</sup> This system will enable the ECB (and the ESRB) to collect all relevant information while reducing the risk of moral hazard in identifying SIFIs. Regrettably, the ECB currently focuses on banking and insurance groups.<sup>232</sup> The importance of other financial institutions and their contribution to system risk was already discussed in section 4 and their inclusion in the tier system is necessary to conduct a reliable macro-prudential supervision.

## 6. Collecting Information is Only the First Step

Collecting the relevant information is a prerequisite to fulfilling the ESRB role of identifying and mitigating systemic risks. Once the information is available the data still needs to be analysed. The analysis stage suffers (even more than other aspects of the ESRB data collection process) from limited amount of evidence that is publicly available. It raises, however, a few questions which have a direct impact on the data collection stage – which model/models will the ESRB use for its macro-prudential analysis? Particularly at the initial stage, will various models be used until their effectiveness can be tested? The answers to these questions are significant to determining the data needs of the ESRB, as different models require different data sets to be collected. It is to be assumed that because macro-prudential analysis is still in its infancy, a multiplicity of approaches will initially be employed.<sup>233</sup>

Before concluding, it is important to bear in mind that analysis is not an objective in itself but rather a means to an end, ie producing corrective action where necessary, in the form of warnings and recommendations. As Claudio Borio of the BIS put it, “The main reason why crises occur is not lack of statistics but the failure to interpret them correctly and to take remedial action”.<sup>234</sup>

## 7. Conclusions

Data are the eyes and ears we use to see and hear what is happening in the financial and economic world. Without it, we are deaf, blind and dumb.<sup>235</sup> The need for

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<sup>231</sup> It is likely that Tier 3 will be a subset of Tier 2. *Ibid.*, p 23. In November 2011 the FSB and BCBS have identified an initial group of 29 globally systemically important banks, see the FSB, *Policy Measures to Address Systematically Important Financial Institutions* (G-20 Cannes Summit, 4 November 2011) <[http://www.financialstabilityboard.org/publications/r\\_111104bb.pdf](http://www.financialstabilityboard.org/publications/r_111104bb.pdf)> accessed 16 April 2012. Interestingly, European banks dominate the list with 17 banks.

<sup>232</sup> Agresti Anna Maria (n 228), p 21.

<sup>233</sup> Lucas Papademos, *Financial Stability and Macro Prudential Supervision: Objectives, Instruments and Role of the ECB* (“The ECB and Its Watchers XI” Conference, Frankfurt, 4 September 2009) <[http://www.ecb.int/press/key/date/2009/html/sp090904\\_3.en.html](http://www.ecb.int/press/key/date/2009/html/sp090904_3.en.html)> accessed 10 November 2011.

<sup>234</sup> Claudio Borio, *The Financial Crisis: What Implications for New Statistics?* (BIS, 25 August 2010) <<http://www.bis.org/ifc/events/5ifcconf/keynotecborio.pdf>> accessed 16 April 2012.

<sup>235</sup> Cecchetti, Fender and McGuire (n 74), p 1.

data is especially acute in macro-prudential surveillance where a bird's eye perspective can be achieved by combining macro as well as aggregated micro-prudential data sets across countries, sectors and financial instruments.

This Article has sought to consider this fascinating aspect of ESRB's macro-prudential oversight. It assessed whether the ESRB has in place a well-functioning data collection process designed to produce, where necessary, concrete warnings and remedial recommendations regarding risks to the financial stability within the EU.

The broad conclusion is that there are indeed various challenges and possible obstacles to smooth flow of information both in the legal frameworks and the practical mechanisms of the data collection process. Yet, the ESRB's information base and its data collection mandate are wide enough to tailor its macro-prudential analysis needs and are far from being a duplicating effort of other national and international players.<sup>236</sup> Existing players, such as the ESCB, the ECB, the FSB, the BIS and the IMF, collected an overwhelming amount of financial data long before the onset of the 2008 financial crisis. These data were not necessarily tailored for macro-prudential analysis or aimed at producing concrete warnings and remedial recommendations. Initiatives taken recently to adapt and enhance their data sets so as to fit macro-prudential analysis needs are welcomed. They will significantly assist the ESRB, given the global dimension of systemic risks. However, an EU focused data collection framework is still indispensable. The ESRB has direct access, through the ESAs, to the necessary micro-prudential data on the financial system within the EU. Furthermore, over time, the ESRB's data collection process will benefit from higher quality data, as the ongoing increased integration within the EU and the creation of a single rulebook<sup>237</sup> will act as a catalyst for the creation of a consistent and comparable financial reporting. Describing the ESRB as a 'toothless' 'talking shop', which will duplicate activities already undertaken by other national and international institutions<sup>238</sup> lacks fundamental understanding of the demanding requirements of data collection for the purpose of macro-prudential supervision. This observation ignores the need for micro-prudential data which is granular enough to enable the ESRB to take action before systemic risks emerge or at least mitigate them. It also ignores the need for the data to be comparable, particularly where so many data sources are involved.

The various impediments to a well-functioning data collection process were highlighted by examining the various channels and data sources. Each one of these channels operates within a different legal framework and, consequently, presents unique challenges for the ESRB in its data collection. Accordingly, the solutions suggested in this Article to refine the process differ from one source to another. For the immedi-

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<sup>236</sup> The Treasury Committee, *Opinion on the Proposals for European Financial Supervision* (Sixteenth Report of Session 2008–2009), para. 49 <<http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/1088/1088.pdf>> accessed 10 November 2011.

<sup>237</sup> The Conclusions of the European Council 19 June 2009 D/09/2 confirmed the role of the ESAs in establishing a single rule book applicable to all financial institutions in the single market, see for instance, Art. 8 of the EBA Regulation.

<sup>238</sup> The Treasury Committee, *Opinion on the Proposals for European Financial Supervision* (Sixteenth Report of Session 2008–2009), para. 49 <<http://www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/1088/1088.pdf>> accessed 10 November 2011.



ate future, it is suggested to promote regular exchange of aggregate information by the ESCB in the same manner already being provided between the ESRB and the ECB. It is also suggested to establish guidelines with the ESAs outlining criteria for handling “reasoned” requests submitted by the ESRB; In time it will be essential to tackle more intimidating tasks: finalising agreements with international institutions relating to the exchange of information and in particular the confidentiality regime to be applied; rectifying impediments to the smooth flow of information within the colleges of supervisors ensuring that the coordination and cooperation process within this framework is maximised. Updating the Colleges Guidelines, as suggested in section 4, could well be the first step to accomplishing this task. The parallel and at times overlapping frameworks of international and European colleges of supervisors will also need to be dealt with in the longer run. A short term solution was suggested to ensure cooperation with third countries through MoUs, covering issues such as information sharing on a regular basis, periodic joint inspection exercises and confidentiality safeguards. Data commercial providers presented various common challenges such as costs and data quality. Yet, the obstacles and the suggested solutions to remove these obstacles differ between trade repositories and credit registers. Currently, the way of accessing data stored in trade repositories is cumbersome however implementation of the EMIR may bring desired convergence in this field. With regard to credit registers, the lack of an efficient framework for exchange of information for supervisory purposes suggests the need to set up a framework for cooperation between the ESRB and EU national central banks and their respective public credit registers and, where necessary, with private credit bureaus.

These refinements and others suggested throughout the article will bring the ESRB closer to a well-functioning and efficient data collection process. Additionally, ensuring the quality of the data being pooled from the various channels is of essence. In order to conduct macro-prudential analysis and produce, when necessary, concrete warnings and remedial recommendations, the ESRB information base must include comprehensive, comparable, timely and accurate data. The data collection task cannot be a one-off exercise. The fast moving and opaque nature of financial markets and the constant search for less or non regulated areas dictate the need for adjustment and revaluation the ESRB data needs. The ESRB will need to continuously challenge information originating from financial institutions to avoid a scenario where the institutions themselves fail to identify risks being taken.

Finally, the 2008 financial crisis and the current sovereign debt crisis reaffirm an already known fact that systemic risks are a global problem and that their measurement and monitoring must have a global dimension.<sup>239</sup> Given this global nature, the ESRB’s success will lie in creating an efficient web of information exchanges with competent authorities and other institutions outside the EU.

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<sup>239</sup> Cecchetti, Fender and McGuire (n 74), p 1.



